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IN THE MATTER OF:)

)

DETERMINATION OF RATES) Docket No.

AND TERMS FOR MAKING AND) 16-CRB-0003-PR

DISTRIBUTING PHONORECORDS) (2018-2022)

(PHONORECORDS III),)

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OPEN SESSION

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9 (PHONORECORDS III),)
10 -----X
11 BEFORE: THE HONORABLE SUZANNE BARNETT
12 THE HONORABLE JESSE M. FEDER
13 THE HONORABLE DAVID R. STRICKLER
14 Copyright Royalty Judges
15
16 Library of Congress
17 Madison Building
18 101 Independence Avenue, S.E.
19 Washington, D.C.
20
21 March 15, 2017
22 9:10 a.m.
23 VOLUME V
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1 P R O C E E D I N G S

2 (9:10 a.m.)

3 JUDGE BARNETT: Good morning. Please be
4 seated.

5 Mr. Steinthal, you changed.

6 MR. STEINTHAL: Yes. Mr. Wetzel will be
7 taking the next witness.

8 JUDGE BARNETT: Okay. Mr. Wetzel?

9 MR. WETZEL: Google calls Dr. Greg
10 Leonard.

11 JUDGE BARNETT: Please raise your right
12 hand.

13 Whereupon--

14 GREGORY K. LEONARD,
15 having been first duly sworn, was examined and
16 testified as follows:

17 JUDGE BARNETT: Please be seated.

18 MR. JANOWITZ: Good morning, Your Honor.

19 JUDGE BARNETT: Good morning.

20 MR. JANOWITZ: Bright and early. We
21 received the slides that accompany Dr. Leonard's
22 testimony last night, and looking through them,
23 there are two, I think two, perhaps it's only one --
24 it's only one that we have an objection to, which is
25 on page 21 of the set of slides. And it addresses

1 the Subpart A ringtone settlement.

2 MR. WETZEL: Yes, so we're not seeking to
3 introduce these slides into evidence. This is a
4 demonstrative for the purposes of accompanying
5 Dr. Leonard's testimony in response to
6 Dr. Eisenach's criticism of Dr. Leonard's
7 application of the Subpart A benchmark in his direct
8 testimony.

9 MR. JANOWITZ: Yes. I understand what --
10 what you have in mind. The problem with it is, and
11 I understand it's not evidence, but clearly it's
12 intended to be part of his testimony, and I thought
13 that our agreement pertained to allowing the witness
14 to address things that came later, say, in rebuttal,
15 which he would otherwise not have an opportunity to
16 deal with.

17 In this case, the ringtone issue was
18 contained in Dr. Eisenach's direct report and was
19 responded to, as best I can recall, in Dr. Leonard's
20 rebuttal. So as far as I'm concerned, we don't have
21 the kind of situation we were talking about. And so
22 I don't think it's appropriate for him to address it
23 in his direct today.

24 JUDGE BARNETT: I'm sorry, I'm going to
25 sneeze. While I'm waiting to sneeze, Mr. Wetzel,

1 would you like to respond?

2 MR. WETZEL: Yes, our understanding was
3 that the -- the witnesses, the expert witnesses on
4 direct would have an opportunity to address
5 criticisms of their direct testimony made in
6 rebuttal by -- by the opposing side's experts for
7 the purposes of -- of joining issue, and so that is
8 -- that's the sole purpose for this slide and for
9 the testimony that's going to accompany it.

10 MR. JANOWITZ: I don't think it was part
11 of his direct.

12 MR. WETZEL: Well, the -- the application
13 of the Subpart A benchmark was part of his direct.
14 And Dr. Eisenach's criticism of -- of his
15 application of the Subpart A benchmark was that he
16 did not apply the ringtone component of that
17 benchmark in his analysis.

18 JUDGE STRICKLER: So, basically,
19 Dr. Eisenach, in essence, restated his ringtone
20 reliance in the nature of a criticism of
21 Dr. Leonard?

22 MR. WETZEL: Correct.

23 JUDGE STRICKLER: And we're talking about
24 page 21 here of the -- of the slides, correct?

25 MR. WETZEL: Yes.

1 JUDGE STRICKLER: And am I correct that
2 the entirety of page 21 is a determination in the
3 prior proceeding?

4 MR. WETZEL: That's my understanding.

5 JUDGE BARNETT: The objection is
6 overruled.

7 MR. JANOWITZ: Yeah, I -- I still have my
8 objection. I understand, obviously, that the -- you
9 know, the nature of what's here is not so much
10 troublesome because it's -- you know, it's available
11 publicly. I just don't think that this is an
12 appropriate time to take Dr. Leonard through this
13 particular piece of testimony because he will deal
14 with it on his rebuttal. That's my only point.

15 JUDGE BARNETT: This direct/rebuttal,
16 rebuttal/direct/rebuttal, surrebuttal/direct is
17 always problematic. So we're going to allow it just
18 for the sake of efficiency. But thank you. Your
19 objection is on the record.

20 MR. JANOWITZ: Thank you very much, Your
21 Honor.

22 MR. WETZEL: Thank you, Your Honor.

23 JUDGE BARNETT: Let's begin with the
24 witness stating his name, please.

25 THE WITNESS: Gregory Keith Leonard.

1 JUDGE BARNETT: Thank you.

2 DIRECT EXAMINATION

3 BY MR. WETZEL:

4 Q. Good morning, Dr. Leonard.

5 A. Good morning.

6 Q. Could you please --

7 JUDGE BARNETT: And --

8 MR. WETZEL: Oh, sorry.

9 JUDGE BARNETT: Sorry. Counsel, you
10 should also identify yourself for the record.

11 MR. WETZEL: Sure, I'm Joe Wetzel from
12 King & Spalding on behalf of Google.

13 BY MR. WETZEL:

14 Q. Dr. Leonard, could you please briefly
15 describe your education for us?

16 A. Yes. I received a Bachelor of Science
17 degree in applied math and economics from Brown
18 University and a Ph.D. in economics from the
19 Massachusetts Institute of Technology, or MIT.

20 Q. And since receiving your Ph.D., what has
21 been the focus of your work?

22 A. The focus of my work, my areas of
23 expertise are microeconomics, which is the study of
24 the behavior of consumers and the behavior of
25 companies, and econometrics, which is the

1 application of statistical methods to economics
2 data. And I started off my career in academics as
3 an associate assistant at Columbia, and then I moved
4 into economic consulting, and I'm now at a
5 consulting firm called Edgeworth Economics.

6 Q. Have you published any works relating to
7 the fields of study that you just mentioned?

8 A. Yes. I have over 60 publications in
9 professional and scholarly journals.

10 Q. Generally speaking, what are some of the
11 subject matters of the topics addressed in your
12 published articles?

13 A. I do a lot of work in competition
14 economics and in intellectual property. Those would
15 be the areas that are relevant for this proceeding.

16 Q. Have you been accepted by other courts as
17 an economic expert in different matters?

18 A. Yes, I have.

19 Q. Approximately how many times?

20 A. I have testified in, I haven't counted
21 exactly, but something over 35 proceedings of one
22 type or another.

23 MR. WETZEL: Your Honors, we offer
24 Dr. Leonard as an expert in applied microeconomics,
25 econometrics, industrial organization economics, and

1 the economics of intellectual property.

2 MR. JANOWITZ: No objection.

3 JUDGE BARNETT: Dr. Leonard is so
4 qualified. Thank you.

5 BY MR. WETZEL:

6 Q. Dr. Leonard, please turn to Google
7 Exhibit 695 in your binder. What is Google
8 Exhibit 695?

9 A. This is my amended expert witness
10 statement.

11 Q. And if you'd turn to the declaration
12 following page 76 of your amended expert witness
13 statement, is that your signature on that
14 declaration?

15 A. Yes, it is.

16 Q. Is Google Exhibit 695 still true and
17 correct to the best of your knowledge, information,
18 and belief?

19 A. Yes, it is.

20 MR. WETZEL: Your Honors, Google moves to
21 admit Exhibit 695.

22 MR. JANOWITZ: No objection.

23 JUDGE BARNETT: 695 is admitted.

24 (Google Exhibit Number 695 was marked and
25 received into evidence.)

1 BY MR. WETZEL:

2 Q. Dr. Leonard, what was your assignment in
3 this case?

4 A. My assignment was to evaluate the -- what
5 I'll call the Google proposal, and, in particular,
6 evaluate its reasonableness in light of -- of the
7 801(b)(1) factors.

8 Q. And did you have some demonstrative
9 slides prepared to accompany your testimony today?

10 A. Yes, I did.

11 Q. What does slide 2 depict?

12 A. This depicts Google's proposal,
13 specifically for the Subpart B standalone portable
14 subscription service. There are a number of
15 different buckets, but for this particular bucket,
16 this is -- this is what the proposal looks like.

17 Q. Can you briefly describe in your words
18 how you understand Google's Subpart B proposal to
19 operate in this particular bucket?

20 A. Sure. I'm happy to -- definitely, it's a
21 little bit complicated. I guess the easiest way to
22 think about it, perhaps, is the first step, you look
23 at what's the greater of two things. The first
24 thing is 10.5 percent of revenue.

25 The second thing is itself the lesser of

1 13.5 percent of sound recording royalty payments, or
2 I think what's called TCC, and an 80 cent per
3 subscriber. So you take the lesser of those latter
4 two things, you compare it to 10.5 percent;
5 whichever is greater you would then proceed with.

6 From that number you would then subtract
7 royalties for public performance rights. And then
8 that leaves you with a royalty for mechanical
9 rights.

10 Q. How, if at all, is Google's proposal in
11 this proceeding for Subpart B different from the
12 existing Subpart B regulations?

13 A. Well, it's similar in a lot of ways, but
14 there are a few differences. So this slide, I
15 think, puts them side-by-side. And you can see that
16 the -- the two primary differences are that the --
17 on the percentage of TCC, so what forms part of the
18 lesser of calculation on the right-hand side,
19 instead of 21 percent of TCC, which was in the
20 current rate structure, Google is proposing lowering
21 that number to 13.5 percent.

22 And then the second big change is that
23 the current rate structure has what's called a
24 mechanical or what I'll call, maybe, a mechanical
25 per-subscriber minimum of 50 cents. So if after

1 doing, you know, the greater of, then minus public
2 performance, if you end up with a number that's less
3 than 50 -- 50 cents per subscriber, then the
4 mechanical royalty would be bumped up to that floor.

5 Google's proposal is that that floor be
6 eliminated. So that's the second big change.

7 Q. And are there any differences with
8 respect to the revenue definitions?

9 A. Yes. So that's -- that's probably --
10 that's a third change. So the third change is that
11 -- that the revenue be subject to a deduction for
12 certain costs that are really related to the
13 generation of that revenue, up to an amount of
14 15 percent. So it could, of course, be zero. And
15 it would be restricted to certain categories, which
16 this slide here suggests. It's things like carrier
17 billing costs, credit card commissions, app store
18 commissions. That sort of thing would be deductible
19 up to 15 percent from revenue before doing the
20 10.5 percent.

21 Q. What did you ultimately conclude about
22 the reasonableness of Google's proposal?

23 A. My conclusion is that -- again, in light
24 of the 801(b)(1) factors, that it is, in fact,
25 reasonable.

1 MR. WETZEL: Your Honors, I'm going to
2 have a brief portion now that -- that covers some
3 restricted material. But we can cover it all in one
4 chunk and then have everybody come in, if we could
5 clear the courtroom.

6 JUDGE BARNETT: Yes. Anyone in the
7 courtroom who is not allowed to see restricted --
8 restricted material or hear restricted information,
9 if you could wait outside, please.

10 (Whereupon, the trial proceeded in
11 confidential session.)

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1 O P E N S E S S I O N

2 BY MR. WETZEL:

3 Q. Now, because we're in open court, we're
4 going to cover this at a level of generality. You
5 mentioned that you considered other direct licenses
6 besides Google's in -- in supporting the structure
7 of Google's proposal here. Can you specify which
8 other Services' direct licenses you looked to?

9 A. I mean, there were various parties that
10 produced licenses. You know, one that might be
11 relevant to some degree is the Pandora agreement
12 because it -- there are some Pandora agreements that
13 have certain elements in it that relate to the
14 Google's proposal that -- that that would be an
15 example.

16 Q. And what --

17 JUDGE BARNETT: Excuse me.

18 MR. WETZEL: I'm sorry.

19 JUDGE BARNETT: Could someone move that
20 chair from in front of the fire door? That needs to
21 be clear at all times. Thank you.

22 BY MR. WETZEL:

23 Q. Why did you conclude that some of the
24 other Services' direct licenses that you looked to
25 were -- were good comparables or benchmarks?

1 A. Well, it was really the same basic
2 reasons that the rights, parties, other elements of
3 the agreement, in general, the economic conditions
4 surrounding them were -- you know, were comparable
5 and similar. So, you know, that again makes them
6 useful comparables.

7 Q. And I believe the third category of
8 benchmark you mentioned were the Phonorecords I and
9 II settlements. What -- what about those
10 settlements led you to consider them good benchmarks
11 here?

12 A. Really the same -- same basic ideas.
13 They are the -- you know, rights and usage, again,
14 are the same or similar. The -- the parties were
15 the same or similar. It was, you know, 2012 versus
16 now, and there are certain things that one would
17 want to look at there, although part of that would
18 go to what the -- whether the minimum floor should
19 be -- sorry, the mechanical minimum floor should be
20 gotten rid of and things like that, that we've
21 talked about a bit.

22 But, overall, again, I think it's a
23 useful comparable and certainly something to look
24 at.

25 Q. And as between Phonorecords I and II, was

1 -- was there one that you found to be a better
2 benchmark?

3 A. Well, I'd say Phonorecords II, simply
4 because it's closer in time, although I understand
5 that, you know, a lot of the elements are very much
6 the same.

7 Q. How does the fact that a lot of the
8 elements are very much the same affect the later
9 settlement's suitability as a benchmark, in your
10 view?

11 A. Well, it's interesting, because it means
12 that between, I think it was, I don't know, 2008 or
13 something like that, and 2012, when the two
14 settlements were entered into, you know, the parties
15 implicitly agreed that not a lot had changed that
16 would cause you to want to change the terms of that.
17 If something huge had happened, they would have, you
18 know, reached a different settlement.

19 Q. I think you -- you discussed the concept
20 of revealed preference in discussing your first
21 opinion. What did -- what did you mean by -- by
22 revealed preference?

23 A. Well, revealed preference is just the
24 idea that when we see somebody do something, if they
25 prefer product A to B -- or, sorry, if they buy

1 product A when they could have bought product B, it
2 means they preferred product A to B.

3 Here you have two parties interacting, so
4 obviously there's a tradeoff between their
5 preferences, but at the end of the day, if they
6 agreed to a particular structure, it means they both
7 found it agreeable. And I think that's an important
8 thing to look at.

9 Q. If we could go back --

10 JUDGE STRICKLER: Do you --

11 MR. WETZEL: I'm sorry.

12 JUDGE STRICKLER: I'm sorry. You said a
13 moment ago that in the context of that revealed
14 preference, that the 2012 settlement basically
15 continued the rates and terms under the Subpart B.
16 So that showed to you that there was no big change,
17 I think that was the phrase you used, there was no
18 big change that would -- that caused the parties to
19 deviate in 2012.

20 THE WITNESS: Correct.

21 JUDGE STRICKLER: Excuse me. In 2012
22 from 2008. So if we use the same analysis that you
23 used, in comparing 2008 to 2012 as a revealed
24 preference to maintain the status quo, if you will,
25 our task would be -- if we adopted your way of

1 looking at it, would be to see whether there was any
2 quote, unquote, big change between the 2012
3 settlement and today, to see whether the -- there's
4 -- the 2012 settlement constitutes an appropriate
5 benchmark. Would that be a fair statement?

6 THE WITNESS: I -- I would say so, as far
7 as the structure, again, goes. You know, because
8 I'm using the Phonorecords II and I primarily for
9 those elements of the structure.

10 And, again, we've seen that Google
11 agreements, for instance, which are more recent, in
12 some cases, than the 2012 Phonorecords that have a
13 similar structure so, again, I would say that's
14 another element in which you can say: Well, you
15 know, in terms of the structure, things haven't
16 changed that much in a way that would cause the
17 parties to want to do something different.

18 JUDGE STRICKLER: You would only do that
19 sort of, for lack of a better phrase, big change, in
20 quotes, big change analysis as it relates to the
21 rate structure and not to the rates themselves
22 within the structure?

23 THE WITNESS: Well, again, I've -- I've
24 suggested that there are certain things that change
25 that should cause us to change some of the numbers

1 in the structure. So I think there are some things
2 one would want to look at to adjust those.

3 But in terms of the overall idea of a
4 percentage of revenue with a minimum that serves as
5 a backstop and that the minimum itself may have both
6 a TCC and per-subscriber component, I think that
7 those are -- that structure is something we see
8 continuously from 2008 forward.

9 JUDGE STRICKLER: So it's the still same
10 temporal -- temporal analysis, the 2012 settlement
11 compared to now, both with regard to rate structure
12 and with regard to the rates in the structure. What
13 you're saying, though, is when you apply that
14 analysis, the structure you think should remain
15 essentially the same but the rates within, then,
16 there have been, in your opinion, big enough changes
17 in the market that the rates within the existing
18 rate structure need to be tweaked in some way?

19 THE WITNESS: Yeah. And then I guess the
20 one change to the structure itself is getting rid of
21 the mechanical-only floor. And I've explained how I
22 do think something has changed there, which would
23 raise concerns about whether that should be in there
24 or not.

25 JUDGE STRICKLER: Thank you.

1 BY MR. WETZEL:

2 Q. If we can go back to your summary of
3 opinions. What was the basis for your second
4 opinion listed on this slide?

5 A. So this is the basis for the second
6 opinion. This is starting to get into more what the
7 numbers within the structure should be. And so for
8 that, I'm using the 2016 Subpart A settlement
9 concerning permanent digital downloads, or PDDs, as
10 a benchmark.

11 Q. Why did you use the Subpart A settlement
12 as a benchmark to assess the -- the topline rates?

13 A. Well, I went through the same list of
14 factors. So let's start with what's being conveyed.

15 The musical works at issue are the same.
16 The rights that are being conveyed are the rights to
17 use -- on the one hand, use as musical works in a
18 PDD service, versus a streaming service. And, you
19 know, at some level, of course, those aren't exactly
20 the same, but I think they're quite similar when you
21 think about what's going on.

22 And in the case of a PDD, and streaming,
23 in both cases you're getting -- it's really about
24 on-demand listening. So in the one case, I'm paying
25 for a PDD. I then get to listen to that as often as

1 I like, basically, for the rest of my life, I guess.

2 In the other case, you're in the
3 streaming service. If you're a subscriber, you pay
4 a fee. And you get to listen to any song in the
5 library as often as I like for the period covered by
6 the subscription fee. And if I kept paying that
7 fee, I would be able to do that for the rest of my
8 life too.

9 So in both cases, you're really getting
10 to listen to what you want to listen to. And, you
11 know, there, of course, again, are differences, but
12 I think in both cases you can think about it as I'm
13 paying for the rights of access to some musical
14 works. And so in that case, they're very similar.
15 And I think, therefore, the Subpart A provides a
16 very good benchmark on that basis.

17 You know, the licensors in both cases are
18 the same. They're the -- the Copyright Owners on
19 the musical works side. In one case, my
20 understanding is Subpart A, the -- you know, it's
21 the -- the licensee side, I guess it's the label
22 because they end up paying, and streaming, of
23 course, it's a Service, so that is somewhat
24 different there. I don't think enough to really
25 matter.

1 It's, you know, a very recent settlement,
2 so it's 2016. And, you know, again, the catch-all
3 category, I think, from my point of view, it's, you
4 know, again, similar economic circumstances. It's a
5 slightly different service but not in a way that
6 really matters. We're talking about cases, about
7 people being able to listen to songs.

8 JUDGE STRICKLER: You mentioned access in
9 your answer. Do you distinguish -- this is not for
10 the moment Subpart A versus Subpart B, but do you
11 distinguish in your analysis between the value of
12 access and the value of use?

13 THE WITNESS: I mean, I think the value
14 of access is that I have some option value. In the
15 case of -- you know, versus use. So, in other
16 words, it might have value to me, even if I never
17 turn out to -- to use it. And that option value can
18 be important.

19 I think, you know, one of the advantages
20 of streaming is that you've got the option, as a
21 subscriber, to listen to the -- to the library. And
22 that's one thing that has made it incredibly
23 popular, one thing that has reduced piracy, one
24 thing that has expanded streaming revenues
25 substantially over, I think, what would be happening

1 with just PDDs.

2 So, you know, there is some value to
3 that, yeah.

4 JUDGE STRICKLER: Do you think the value
5 of access to streaming is greater than the value of
6 access when you have a digital download?

7 THE WITNESS: Well, you're -- you're
8 getting access to a library. So in that sense, yes.

9 JUDGE STRICKLER: Which one are you
10 talking -- you're talking the Subpart B streaming?

11 THE WITNESS: Streaming, yes, sorry.
12 Now, of course, you'll see I'm going to talk about
13 here ratios of a royalty to a revenue. And, of
14 course, you know, to the extent there's value in
15 access, that's going to -- you know, that's wider --
16 a little bit wider for one than the other, that's
17 going to be present in both the numerator and
18 denominator and kind of cancel out.

19 So I think the fact that PDDs are just --
20 the access there is limited to just the song that
21 we're talking about is not enough to disqualify it
22 when you look at it the way I'm looking at it, which
23 is the ratio of the -- of a royalty to a revenue.
24 Particularly because I think if you think about it,
25 the idea of providing somebody access to the

1 library, which, again, has been so popular, that's
2 part of the streaming company's business model.

3 And, you know, I think at some level, you
4 can say they deserve credit for that in terms of the
5 contributions. So to the extent that they basically
6 created this additional value, managed to get more
7 revenues from streaming than might exist if only
8 PDDs were out there is something that, of course,
9 they deserve credit for.

10 Now, by using a percentage of revenue,
11 I'm going to be giving some of that -- not I -- of
12 course, the Google proposal will be giving some of
13 that to the -- to the Copyright Owners as well. So,
14 again, I think percentage of revenue has that nice
15 feature about it, that increases in value get split
16 automatically between -- between the parties.

17 BY MR. WETZEL:

18 Q. Just referring quickly to your fourth
19 bullet there, in evaluating the comparability of
20 Subpart A, what were some of the economic
21 circumstances that you considered in arriving at the
22 -- the conclusion that Subpart A was a good
23 comparable for Subpart B?

24 A. You mean besides the one I've talked
25 about already?

1 Q. Yes. Were there -- were there any other
2 economic circumstances in forming your conclusion
3 that Subpart A was a good comparable for Subpart B?

4 A. I'm trying to think what I've said
5 already, if there's anything else. I don't know.
6 Not -- not anything I can think of at the moment.

7 Q. We can come back to that in a bit.

8 So how -- how does the Subpart A
9 settlement ultimately inform your analysis of the
10 appropriate headline rate to use for Subpart B?

11 A. Well, so what I ended up doing here,
12 again, is -- is thinking about it this way, and if
13 you take a bunch of rights to the musical works, you
14 combine them with the assets of the Service, and at
15 the end of that comes out some revenue because
16 you've created something that's attractive to -- to
17 consumers who want to listen to music. And so PDDs,
18 you've got that kind of service. And streaming,
19 you've got a different kind of service.

20 And the question, again, is how to break
21 up that revenue, what percentage of that do we
22 assign to each of the parties. How do we apportion
23 it, is another way to think about it.

24 And, you know, the sort of percentage of
25 revenue or apportionment or contribution of the

1 musical work for streaming, I think, is quite
2 comparable to think about it in terms of what's
3 going on in Subpart A because of PDDs, that the
4 percentage of revenue, that the apportionment should
5 be roughly the same.

6 Now, as I mentioned, I think there are
7 reasons to think the streaming service could say,
8 wait a minute, we're -- we're actually doing a lot
9 more than the people who sell PDDs; we deserve a
10 bigger apportionment. But as we'll see, Google's
11 proposal is actually quite conservative in that
12 regard.

13 Q. And sitting here now, are you able to --
14 to walk us through some of your calculations
15 applying the Subpart A benchmark to the Subpart B
16 context?

17 A. Yes, sure, please. So the first part of
18 this, as I mentioned, I'm going to be looking at the
19 percentage of revenue that the royalty is for
20 musical works for PDDs, and that's going to serve as
21 a benchmark for what the percentage of revenue
22 should be on the streaming side.

23 So I need to do two things. First of
24 all, I need to figure out what is the -- the royalty
25 payment for musical works and I need to determine

1 what the price per PDD is.

2 So my first, for the latter thing, what's
3 the price of a PDD, that's the revenue side. I
4 looked at data from the RIAA. They get some
5 information on revenue and shipments for singles and
6 albums. I ultimately need to get to a price per
7 song, so, I made some assumptions about how many
8 songs per album there were on average and -- and
9 then took a weighted average between albums and
10 singles. And that led me to the price of a song, as
11 you can see in the red box here.

12 It started off for PDDs, you paid about
13 99 cents for a song on average. And then it has
14 increased a bit over time. And by 2015, it was
15 \$1.10.

16 Q. And just for reference, this slide,
17 without the red box, depicts Exhibit 7 from Google
18 Exhibit 695; is that correct?

19 A. That's correct, yes.

20 JUDGE STRICKLER: Dr. Leonard, you said
21 you made an assumption about how many songs there
22 were per album. How did you arrive at your
23 assumption?

24 THE WITNESS: I believe that's an
25 assumption that's actually -- if I'm remembering

1 right, is used by the RIAA. And I did some
2 sensitivities to, you know, see if it was 11 versus
3 9, whether that would matter too much. And it
4 doesn't matter too much.

5 JUDGE STRICKLER: Thank you.

6 BY MR. WETZEL:

7 Q. What was the next step of your
8 calculation?

9 A. So the next step is I've got to figure
10 out what the musical work royalty is. And I guess I
11 should step back for a moment and say here on the
12 PDD side, there only is, as I understand it, a
13 mechanical right, that that's all you need to sell a
14 PDD.

15 So I know that, you know, there's -- on
16 the interactive streaming side, there's a mechanical
17 and a performance, but as I think has been talked
18 about already, you know, they're perfect
19 complements. So, I mean, a mechanical right, when
20 there's two of them, a mechanical right is pretty
21 worthless unless I have the performance right.

22 So if you only need one of those rights,
23 that is effectively the all-in royalty for a musical
24 work. So that's an important point to make as well.
25 But, anyway, on the -- on the PDD side, the question

1 is what is the royalty for a PDD?

2 And there's a formula that comes out of
3 the Subpart A numbers. And basically what it is, is
4 you pay 9.1 cents for any song that's less than or
5 equal to five minutes. And then for songs that have
6 a length greater than five minutes, you basically
7 round up to the higher number of minutes, so
8 something that's, say, five minutes and 1 second
9 gets rounded up to 6. And then you -- you
10 multiply .0175 times the six minutes, and then you
11 do that for the song.

12 Then you do a similar thing for songs
13 that are up to seven minutes -- between six and
14 seven minutes long, et cetera, et cetera. And then
15 you add up all those numbers and divide by the
16 number of tracks. And that gives you an average
17 royalty per -- per PDD. And it turns out to be
18 about 9.5 cents.

19 Q. Just going back to that last slide for a
20 minute, just to be clear, this slide is not
21 suggesting that seven minutes was the longest song
22 that you encountered in your analysis, was it?

23 A. No, the three dots, little black dots
24 there at the bottom means this goes out as long as
25 there are songs, you know, until you reach the

1 longest possible song in the data set.

2 Q. And how, if at all, did you account for
3 non-music tracks or for other tracks that wouldn't
4 require a Section 115 license when you were
5 performing this calculation?

6 A. Yeah, there's no real way to identify
7 those and pull them out like you might want to do.
8 So I just, you know, implicitly left them in the
9 calculation. But that was likely to be conservative
10 because, you know, public --- public domain works
11 like classical works tend to be longer, of course,
12 so they would add incrementally to this.

13 Q. And ultimately going to the next slide,
14 again, what is 9.5 cents per download as a
15 percentage of the sales price of downloads in each
16 of 2006 and 2015?

17 A. Yeah, so if you take the price numbers
18 that were in that spreadsheet that had all the
19 numbers in it, and you divide that into the 9.5
20 cents per song, which -- the one assumption I should
21 point out I'm making here is that the -- sort of
22 distribution of song length hasn't changed markedly
23 over 2006 to 2015. So that I can use the 9.5 cents
24 in both -- both years.

25 But if you divide that by the price in

1 each year, you get 9.6 percent in 2006 and
2 8.7 percent in 2015. So these would be the
3 percentages that the musical work royalty is as a
4 percentage of the revenue from physical downloads --
5 I'm sorry, permanent digital downloads.

6 Q. And how did you ultimately arrive at your
7 ultimate range of 11.3 percent and 10.2 percent of
8 revenue?

9 A. Well, so to make this more comparable to
10 Google's proposal, if you'll remember the proposal
11 had a potential deduction of 15 percent from
12 revenue, so what you would want to do is -- is to
13 make it comparable and ask, you know, what would
14 these percentages be if there was an allowable
15 15 percent deduction from revenue.

16 So I basically redid the math but taking
17 15 percent off of 99 cents and \$1.10 respectively.
18 And that increases the percentages to 11.3 percent
19 in 2006, which it declined to 10.2 percent by 2015.

20 So Google's 10.5 percent, if applied to
21 revenue after a 15 percent deduction, you know,
22 their 10.5 percent number is in this range here.

23 Q. What, if anything, is your understanding
24 of -- of whether Google, in particular, would be
25 entitled to take the full 15 percent deduction that

1 it's proposing?

2 A. I think if you look at what -- those
3 categories of deductions that Google is proposing to
4 be allowed, really the only one Google, as I
5 understand it, would qualify for are the -- the
6 credit card fees, which tend to be in the 1 to
7 3 percent range. So for Google, it would be
8 substantially less than 15 percent.

9 Q. And in -- sorry, go ahead?

10 JUDGE STRICKLER: A question, just so I
11 understand. I think some of the summary, correct me
12 if I'm wrong, is on page 48 --

13 THE WITNESS: Of my report, you mean?

14 JUDGE STRICKLER: Yeah, I'm actually
15 looking at your original one, and I know you
16 supplemented or amended it, so hopefully I'm right.

17 And at paragraph 76 in that -- I should
18 look at your -- you amended one, so I get it
19 correctly.

20 MR. JANOWITZ: Your Honor, if I could
21 help, we did the conversion. So paragraph 76 of the
22 original is now paragraph 78 of the amended.

23 JUDGE STRICKLER: I'd like you to look at
24 paragraph 78 of the amended.

25 THE WITNESS: Okay, I'm there.

1 JUDGE STRICKLER: Okay. So if I
2 understand correctly, then, one of -- one of your
3 opinions here is, looking at the first bold dot
4 there, you have the economically appropriate all-in
5 minimum royalty for a Section 115 license. Do you
6 see that?

7 THE WITNESS: Yes.

8 JUDGE STRICKLER: And then in the second
9 dot underneath that, you say "the upper end of this
10 range, 15.5 percent."

11 Do you see that?

12 JUDGE FEDER: 15.8.

13 THE WITNESS: Yeah, I would --

14 JUDGE STRICKLER: Maybe -- maybe it has
15 changed since. It's 15.8 on the amendment?

16 THE WITNESS: It is. Can I also say this
17 is the -- the part that's addressing percent of TCC,
18 I believe.

19 JUDGE STRICKLER: It's just service
20 payments?

21 THE WITNESS: Yeah. So the part that
22 we're talking about right now comes earlier, and
23 it's -- it's in my paragraph 73 of the amended
24 report. I'm not sure what that would translate to.

25 JUDGE STRICKLER: Maybe 75.

1 THE WITNESS: But it would be right under
2 -- the section heading is C, and then there's a
3 subsection 1, benchmark, all-in topline royalty
4 rate. That -- what I'm talking about now
5 corresponds to that part.

6 JUDGE STRICKLER: Thank you.

7 BY MR. WETZEL:

8 Q. Now, the moment we've been waiting for.
9 In his rebuttal testimony at paragraphs 46 and 47,
10 Dr. Eisenach criticized your application of the
11 Subpart A benchmark because you did not rely on
12 Subpart A's rate that pertains to ringtones. How --
13 how would you respond to that criticism?

14 A. Well, I would say that the usage of the
15 musical work in the ringtone context is -- is very,
16 very different. And so it's -- you know, from that
17 perspective, it's not a good comparable. People
18 aren't buying ringtones to listen to music. They're
19 buying them to be ringtones.

20 Q. And was there anything else that informed
21 your decision that -- or your conclusion that --
22 that ringtones were not good comparables for use in
23 evaluating Google's proposal under Subpart B?

24 A. Well, I would say I just -- there was a
25 CRB decision that, you know, basically makes the

1 same point I'm making right now, which is that --
2 they're calling it master tones, but this would be a
3 ringtone, is not a substitute for somebody who wants
4 to listen to music. You know, you're not going to
5 go out and buy a bunch of ringtones in order to
6 listen to music.

7 And as a result of that the -- you know,
8 as I understood, the CRB declined to use ringtone --
9 they used certain ringtone agreements as comparables
10 for ringtones, but they declined to use those for
11 other things such as PDDs.

12 Q. And as an economic matter, do you agree
13 with the conclusions reached by -- by the Board in
14 this determination?

15 A. Absolutely, yes.

16 Q. Now, in his rebuttal testimony at
17 paragraphs 48 to 52, Dr. Eisenach also criticized
18 the use of the Subpart A benchmarks for Subpart B
19 and C services because of differences between the
20 concepts of ownership and access.

21 How would you respond to that criticism?

22 A. You know, I'm an economist, not a lawyer.
23 So I can't really opine on legal aspects, but, you
24 know, again, at the end of the day, somebody is
25 buying a PDD, is buying it to listen to it.

1 Somebody who is -- you know, on demand, as many
2 times as they want. Somebody who is subscribing to
3 a streaming service is doing that so they can listen
4 to music, again, any song in the library as often as
5 they want.

6 You know, to the extent that ownership
7 provides some small incremental benefit, you know,
8 that, again, should be reflected in both the
9 numerator and the denominator of the ratios that I'm
10 looking at here and, therefore, kind of cancels out.

11 I don't think that's enough of an issue
12 to disqualify it as a benchmark in this proceeding.
13 I think it's still a very, very useful benchmark.

14 Q. Now, after determining that Subpart A
15 supported Google's percentage of revenue proposal or
16 that portion of its proposal, what other parts of
17 Google's proposal did you evaluate using Subpart A
18 as a benchmark?

19 A. You can also use it to evaluate the
20 13.5 percent of TCC, which is part of the minimum
21 prong.

22 Q. And what conclusion did you reach about
23 Google's proposal with respect to the TCC prong?

24 A. Again, I think in light of what has
25 happened on the Subpart A side of things with

1 physical PDDs, that it has -- that -- you know, that
2 it justifies the 13.5 percent as reasonable.

3 Q. How did you reach your conclusion?

4 A. I went through a very similar exercise as
5 I talked about before, but now instead dividing the
6 musical work royalty by the -- by the price of a PDD
7 or the revenue that is generated by the PDD, I
8 divided the musical work royalty by, effectively,
9 the sound recording royalty rate, which as I
10 understand it to be, you know, 70 percent, out of
11 which the musical work royalty is paid. So you have
12 to make an adjustment for that.

13 But the ratio of the musical works to the
14 sound recording royalties, once you've done all
15 that, is -- was 15.8 percent in 2006, and it
16 decreased to 14.2 percent by 2015.

17 Q. Google's proposal for its TCC prong is
18 outside of this range that you just identified. Why
19 did you nevertheless conclude that it was
20 reasonable?

21 A. It's reasonable because -- even though
22 it's outside the range, because the -- you do see a
23 decline from 2006 to 2015, which is being driven by
24 the fact that the musical work royalty has basically
25 remained constant, while the price of a PDD has

1 increased, and because the sound recording royalty
2 is based on a percentage of that, the sound
3 recording -- recording royalties have increased as a
4 result.

5 And so that's why the percentage has
6 fallen. But the fact that it has fallen and it
7 looks like, you know, in 2016 it will likely fall
8 again suggests the 13.5 percent on a going-forward
9 basis is a reasonable number.

10 Q. And what -- what is your understanding of
11 how the -- of what the rate will be for -- for the
12 mechanical royalty associated with download sales
13 through the end of the license period here in 2022?

14 A. Well, it will remain, again, subject to
15 small changes in the distribution of music, the
16 length of songs, assuming that doesn't change, the
17 royalty basically is going to remain the same over
18 time at a -- in a dollar level.

19 And, again, PDDs are, you know, likely to
20 increase. They've increased in 2016. So that would
21 suggest, again, that this ratio is going to continue
22 to fall.

23 Q. Okay. Now I'd like to discuss the third
24 of your summarized opinions. You also considered
25 the -- the 801(b) factors as part of your

1 benchmarking analysis; is that correct?

2 A. Yes, I did.

3 Q. And are these the factors that you
4 considered on this slide?

5 A. They are.

6 Q. How, if at all, did your analysis factor
7 in the 801(b)(1) factors?

8 A. Well, you want to look at -- at Google's
9 proposal and ask, you know, does it meet these
10 factors? Is it consistent with them? Will it
11 further them? And that's one of the things I looked
12 at.

13 Q. Starting with the first of the 801(b)(1)
14 factors, how did you interpret this factor for
15 purposes of your analysis?

16 A. Yeah, and the -- the question is the
17 availability of music works to the public. And, you
18 know, as in a lot of things, this has two sides.
19 You've got the -- the people who write the songs,
20 but, of course, then you also have the Services that
21 provide the streaming services that people are
22 actually using.

23 And, you know, one of the things that
24 we've seen under the existing structure is that
25 there are, you know, a number of competing streaming

1 services out there. They all tend to offer
2 something somewhat different in some way. So it's
3 so-called differentiated product offerings.

4 And that's something that, you know, I
5 personally have studied, you know, how important
6 product differentiation is for consumers, because
7 what you have are products with different
8 characteristics and different attributes, and you
9 have people, consumers, with different preferences.

10 And when you're able to match up people's
11 preferences to a bunch of, you know, different
12 plans, you're able to satisfy consumers' desires
13 better. And that leads to better, you know,
14 economic outcomes from an economist's point of view.

15 So, you know, that's what we see now.
16 We've got something like Spotify, which is a pure
17 standalone service. That's what they do. They've
18 got both an ad-supported component that, you know,
19 would appeal to consumers with lower willingness to
20 pay for music. They've got the subscription
21 offering that appeals to people with greater
22 willingness to pay. That's fantastic because now
23 everybody gets to stream, subject to, you know,
24 their willingness to pay and their -- and, you know,
25 the prices obviously differ for that.

1 You have other Services, you know, such
2 as Amazon that's doing something different than
3 Spotify is doing. You have Google and Apple that
4 are themselves doing something and leveraging their
5 brand names and their platforms that they have
6 already, which may make them able to offer a better
7 service or one that's attractive to certain customer
8 segments.

9 So all of these things are good and have
10 happened under the existing structure, and at the
11 end of the day, Google's proposal, by sticking with
12 the similar structure and by sticking with numbers
13 that are in the end pretty similar to what we've
14 had, I think is going to continue this -- this
15 situation, which is a good one.

16 I should also point out that the
17 all-you-can-eat plans, I think, are a crucial
18 element of this too because as we talked about
19 having access to the library, it has value, it has
20 the option values, encourage people to listen to
21 songs they probably would never have listened to,
22 you know, allows them to listen to more, from my
23 perspective, again, from the point of view of an
24 economist, availability. You know, it's part of the
25 availability. If I can and do listen to more music,

1 that's a good thing under this factor.

2 Now, on the other side, you've got the --
3 you know, the songwriters. And, you know, I've
4 looked at the numbers. There is really no evidence
5 that, for instance, you know, songwriters are --
6 under the existing situation, you know, are being
7 harmed. Certainly, the publishers aren't being
8 harmed. They appear to be profitable.

9 JUDGE STRICKLER: I have a question for
10 you --

11 THE WITNESS: Yes.

12 JUDGE STRICKLER: -- about that, they
13 appear to be profitable. So if we define
14 profitability as the absence of harm, then, of
15 course, you're correct. But there's always the
16 question of, for example, substitution or more
17 broadly the question of opportunity cost.

18 THE WITNESS: Correct.

19 JUDGE STRICKLER: Did you examine whether
20 or not the Copyright Owners have been harmed in
21 terms of incurring an opportunity cost that caused
22 their profits to be lower than they otherwise would
23 be because of this existing rate structure?

24 THE WITNESS: No, I think it's exactly
25 the opposite, actually. So, I mean, what we've seen

1 is, before streaming really became what it is today,
2 you had PDDs and those revenues from that were
3 declining and -- and royalties from that were
4 declining. Streaming became more popular. That has
5 turned around that trend. And you see that, I
6 think, everybody, maybe outside of this proceeding,
7 acknowledges that -- that streaming has benefitted
8 owners of -- of copyrights, both on the performance
9 side -- I'm sorry, on the sound recording side and
10 on the publishing side for the musical works side.

11 So I think the -- the structure, to the
12 extent that, again, it has led to something like the
13 all-you-can-eat plan, which is very attractive,
14 which then gets people away from piracy, which gets
15 people willing to listen to music more and pay that
16 money, you know, are people who, again, weren't, you
17 know, willing to pay that money but they are willing
18 to endure some ads.

19 Okay. So the ads generate money on those
20 people. That, to the extent that the existing
21 structure is part of what enabled that, and I think
22 it is, then that's something that has benefitted
23 musical work Copyright Owners.

24 JUDGE STRICKLER: I think a criticism --
25 and it may come up in your testimony now, but a

1 criticism made by -- by Dr. Eisenach is that when
2 you have an all-you-can-eat type of plan -- and
3 unless I'm mistaken, I think he may have made the
4 point literally an all-you-can-eat plan is a -- is a
5 buffet lunch. All-you-can-eat, you pay a fixed
6 price, then you can eat all you want.

7 But the ingredients that go into the
8 all-you-can-eat buffet are not paid for. The
9 suppliers are not paid as a percentage of the
10 revenue, necessarily, for other people who come in
11 and buy the lunch at retail, who supply the salad,
12 the meats, the dressings, what have you. They all
13 get paid on a per unit basis.

14 So why is it necessary on an
15 all-you-can-eat basis type of economic structure at
16 the retail level to have a percentage of revenue
17 approach in the upstream market?

18 THE WITNESS: Well, two things. One is,
19 you know, the -- the incremental cost or marginal
20 cost to a musical works rights owner of having one
21 more stream is -- you know, for someone who is in a
22 plan like that is zero. So, you know, the right way
23 we think about those things I think typically is to
24 say, look, you know, we can't have, obviously, the
25 price for streaming be zero. I totally agree with

1 that.

2 But the right way to price it is to have
3 price for access to the library and then let
4 somebody listen as much as they want. That's very
5 attractive to the user. It doesn't punish
6 additional usage. It's -- under this factor we're
7 talking about here, it's -- it's fantastic because
8 people can listen more.

9 JUDGE STRICKLER: Are you distinguishing
10 there between -- using the analogy that I made,
11 which I think I got from Dr. Eisenach, that the
12 supplier who supplies tomatoes to the literal
13 all-you-can-eat buffet has a positive marginal cost
14 to -- to grow and transport and deliver the -- the
15 tomatoes as opposed to the marginal physical cost of
16 an extra layer on top?

17 THE WITNESS: Yeah, I think, exactly,
18 that's an important distinction. And, I mean, it's,
19 you know, not uncommon to see in intellectual
20 property licenses that people pay a lump-sum royalty
21 and then on -- you know, the user gets to use it as
22 much as they want.

23 That's not exactly uncommon for exactly
24 this reason, is you really don't want to punish the
25 usage because, again, marginal cost is zero. You'd

1 like to collect at the access point and then make
2 the product as attractive as possible thereafter.

3 JUDGE STRICKLER: Is that in the nature
4 of price discrimination, which is a result of the
5 fact that marginal physical cost is zero?

6 THE WITNESS: Well, I would say that the
7 -- I don't know if it's price discrimination. It's
8 just the idea that in that kind of situation, you
9 want to provide or pay -- you want to collect at the
10 access point. And then by allowing somebody, since
11 it doesn't cost you anything more at that point, to
12 listen as much as they want, it's much -- the whole
13 package is much more attractive to them. And then
14 they're going to be willing to pay more at the
15 access point.

16 JUDGE STRICKLER: They pay more at the
17 access points, but the units they consume, once they
18 have access, the price varies depending on how --
19 the more they use, the cheaper the unit price. So
20 that would be price -- effectively price
21 discrimination.

22 THE WITNESS: Oh, I see what you're
23 saying. I see. Yeah, and that's -- but then,
24 again, what we can do is have different plans with
25 different types of access that are priced

1 differently. So the ad-supported where you're not
2 actually paying a price but you have to endure the
3 ads, versus, you know, something where you're paying
4 for a subscription and then you've got the family
5 plans that might be priced differently.

6 So through the access and the way you
7 charge for that and the way those plans are set up,
8 you can do some price discrimination at that point.
9 Again, the idea of offering different plans to
10 different people with different willingness to pay.

11 JUDGE STRICKLER: Thank you.

12 BY MR. WETZEL:

13 Q. Now, I believe you've touched on this in
14 the -- in the course of responding to Judge
15 Strickler, but what is the interplay of royalty
16 rates and structure with the ability to engage in
17 product differentiation?

18 A. Well, so, again, if you have a percentage
19 of revenue type royalty, you can offer a plan, for
20 instance, at a lower price that's targeted at
21 customers with lower willingness to pay.

22 Basically, what we're saying is customers
23 like that are going to have lower value for the
24 music, even though it's the same -- same music. You
25 would like to be able to get them onboard by being

1 able to charge them a lower price. The musical work
2 should get a lower dollar royalty because the works
3 have less value in that context.

4 And a percentage of revenue royalty may
5 not sound perfect, but it does achieve that kind of
6 flexibility that I can -- you know, I offer a lower
7 price, I pay a lower royalty, it's the same
8 percentage, but I pay a lower dollar royalty, and
9 it's a much more attractive for me to offer that
10 kind of plan than if I were paying, for instance, a
11 fixed dollar royalty regardless of -- of the revenue
12 I was generating.

13 Q. And in your opinion, what does the
14 current state of the industry with respect to
15 Services' profitability tell us about the current
16 rates and rate structure as they pertain to the
17 objectives of -- of factor A?

18 A. Well, you know, I think it's well
19 acknowledged in the industry that, you know, none of
20 the Services are making any -- making any money.
21 And so, you know, it tells you that, if anything,
22 the existing rate structure might be a little bit
23 too high.

24 But from my perspective, you know, one
25 thing that's nice, I guess, about this, is that,

1 whatever it is, five years, this can all be
2 re-evaluated. So, again, I think in Google's
3 proposal, there might be a -- depending on the
4 amount of that deduction, there might be a small
5 reduction in the royalties that are paid, but, you
6 know, largely it's keeping that -- that structure
7 intact.

8 Q. Now, the second 801(b) factor you
9 considered was the -- the fair return factor, we'll
10 call it.

11 How, if at all, did this factor influence
12 your analysis?

13 A. Yeah, so this is -- I put here the fair
14 return and the relative contributions sort of
15 together. As an economist, I kind of think about
16 them together. So, you know, I think what you would
17 look at here, what I looked at here were, you know,
18 the fact that service providers, as we were just
19 saying, are -- do not appear to be profitable, at
20 least to date. You know, again, that could change.
21 And, you know, we can look at things at some later
22 point in time if they have changed substantially.

23 You know, in terms of the percentage
24 rate, again, I mentioned this a bit before, I think
25 there's an argument that the contributions of

1 service providers are in some sense greater here
2 than they are in the context of a PDD, and yet the
3 percentage rate that I'm using or that Google is
4 proposing, I should say, is -- is a bit higher than
5 -- than the PDD numbers that we looked at.

6 And, you know, lastly, you know, again,
7 under the existing structure, it does not appear
8 that the music publishers are themselves
9 unprofitable.

10 So I think that, again, it says the
11 existing structure probably looks pretty good, maybe
12 the rates are a little bit too high. But, again, I
13 think there's not a lot of evidence that, you know,
14 radical changes are needed. And, again, Google's
15 proposal, I don't think, makes radical changes to
16 the -- to the rates.

17 JUDGE STRICKLER: Would you describe,
18 Dr. Leonard, your opinion as you just gave it with
19 regard to fair returns and fair income, are those
20 economic -- does that require economic expertise or
21 is that more -- maybe a better way to ask the
22 question is can an economist identify what
23 constitutes a fair return or a fair income?

24 THE WITNESS: Yeah, that's a -- that's a
25 good -- good question. And I think economists, I

1 would say, you know, typically don't do fair, is
2 what I would say. My concept of fair, what I took
3 to mean here and what I think a lot of economists
4 would say is that if you have -- again, putting two
5 factors together, if you have a negotiation between
6 two parties and there are no, you know, constraints
7 such as holdup, you know, which is a concern, of
8 course, in patent licensing, and there's no market
9 power or any of that, you know, that will lead to a
10 split that's -- that's in accordance are the
11 relative contributions, and then that, itself -- you
12 know, again I hesitate to use the word, so maybe
13 I'll put it in quotes, would be fair. Because, you
14 know -- to an economist, what we want is for -- when
15 different parties come together, they both make a
16 contribution, we really want the return that they
17 get out of it to be in proportion to their relative
18 contribution. That's how we get the right
19 incentives lined up.

20 JUDGE STRICKLER: When -- when you
21 wrestle with the question as an economist of having
22 to figure out what would be a "fair return" or "fair
23 income," do you conceptualize one of the dichotomies
24 that exists in economics between positive economics
25 and normative economics?

1 THE WITNESS: Yeah, good question. Well,
2 I think I would, again, define fair the way I did,
3 which is -- I mean, I think the idea that, I mean,
4 that's -- saying that, you know, I think if there's
5 no market power, then we get to a -- an outcome that
6 would split or apportion the returns in relation to
7 relative contributions, I guess that's probably, you
8 know, somewhat of a positive view, but then to say
9 that that itself is what I might call fair maybe is
10 more of a normative one.

11 And I think as an economist, again,
12 that's probably kind of the best I can do.

13 JUDGE STRICKLER: You mentioned market
14 power in your answer, and I was going to wait, but
15 now you've -- you've mentioned it and so opened the
16 door a little bit.

17 THE WITNESS: Sure.

18 JUDGE STRICKLER: This goes back -- goes
19 into your testimony. You talk -- you seem to talk
20 about market power in two different places in your
21 report. And I don't see where you pick up the
22 thread again. I want to see, make sure I got that
23 right.

24 And, again, I apologize I'm looking at
25 your original report. So, counsel, I'm going to ask

1 you for your help again. Paragraph 14 of the
2 original report. It starts with "music publishers
3 are entities." 15, 15.

4 THE WITNESS: 15?

5 JUDGE FEDER: It's on page 8.

6 JUDGE STRICKLER: Page 8.

7 THE WITNESS: Oh, so I -- I'm there.

8 JUDGE STRICKLER: Okay. Towards the end
9 of the paragraph, you have a sentence that reads --
10 that begins with "these firms hold." Do you see
11 that sentence?

12 THE WITNESS: Yes.

13 JUDGE STRICKLER: Okay. You say, "These
14 firms hold a significant combined position,
15 controlling the majority of the U.S. music
16 publishing market." By "these firms," you're
17 referring to the three immediately above that,
18 Sony/ATV, Warner/Chappell, and Universal Music
19 Publishing.

20 Do you see that?

21 THE WITNESS: I do.

22 JUDGE STRICKLER: You mention that. Does
23 the fact that you understood that they had
24 significant -- a significant combined position
25 controlling the majority of the U.S. music

1 publishing market inform you in any way as to your
2 opinion in this proceeding?

3 THE WITNESS: Well, I think it to some
4 extent goes to, you know, the market power question
5 and what could happen on the performance side that
6 then is part of what I'm worried about regarding the
7 mechanical floor. So I would say, yes, you know,
8 this is just sort of just a statement about what
9 their -- what their share is, but as a general
10 matter, yeah, that market power concern is part of
11 what I'd be worried about.

12 JUDGE STRICKLER: Okay, but as opposed to
13 what you would be worried about and what you
14 declared yourself to be worried about in your
15 testimony, am I correct or incorrect that you never
16 say anywhere else in your -- in your testimony that
17 because these firms hold this significant combined
18 position, this impacts the market and the proposed
19 rates, following that. That -- you know, that I'm
20 correct that -- am I correct that you never pick up
21 on that thread later on in the -- in your report?

22 THE WITNESS: I confess I'm not sure I've
23 got sort of things I've said in this report in my
24 mind separated out from what I might have said in my
25 deposition or my second report. So I'd have to kind

1 of go through here and see.

2 JUDGE STRICKLER: Well, you'll probably
3 be on for a few hours and we'll have a -- maybe you
4 will be on after lunch. So if you want to take a
5 look if there's anything where it picks up.

6 THE WITNESS: Okay. Sure, I will do
7 that.

8 JUDGE STRICKLER: And while we're on such
9 a subject, paragraph -- I guess it will be 18 now.
10 I'm going to try to make an educated guess.

11 MR. JANOWITZ: Formerly 17, Your Honor.

12 JUDGE STRICKLER: We'll see. Thanks.
13 Towards the end of -- of that paragraph, it's the
14 paragraph, I should say, where the words begin -- I
15 apologize. It begins -- the paragraph is numbered
16 probably 18, "a record company (or label)."

17 Do you see that one?

18 JUDGE BARNETT: That is 18.

19 JUDGE STRICKLER: Paragraph 18.

20 THE WITNESS: Yeah.

21 JUDGE STRICKLER: Okay. So I'm going to
22 -- you don't have to read the whole paragraph. I'm
23 just -- I'm taking you down to --

24 THE WITNESS: Oh, I'm sorry. Yeah.

25 JUDGE STRICKLAND: I just want to have

1 you locate the paragraph.

2 THE WITNESS: I have.

3 JUDGE STRICKLER: To help me out since I
4 was remiss in not going to your amended report.
5 About a little more than halfway down, you say,
6 "There are major record labels." Do you see that?

7 THE WITNESS: Yes, I do.

8 JUDGE STRICKLER: Okay. So it says,
9 "There are major record labels and independent
10 record labels. Universal Music Group, Sony Music
11 Entertainment, and Warner Music Group are the
12 primary major record labels. These major record
13 labels share common corporate ownership with the
14 major music publishers discussed above -- for
15 example, Sony Corporation owns SME and half of
16 Sony/ATV; Universal Music Group owns Universal Music
17 Publishing; and Warner/Chappell is a division of
18 Warner Music group."

19 Do you see that?

20 THE WITNESS: I do.

21 JUDGE STRICKLER: Okay. Same question as
22 I asked you before with regard to picking up on the
23 thread of something. Do you utilize your
24 understanding of this common corporate ownership to
25 inform you in your report as to what the rate

1 structure should be in this proceeding? Or the
2 rates themselves?

3 THE WITNESS: Again, it plays a role, I'm
4 quite confident, somewhere in one of my reports.
5 Whether it's here or not is -- in this particular
6 initial report, I don't know. So I'll have to take
7 a look too, if I have the opportunity.

8 JUDGE STRICKLER: Okay, thank you.

9 BY MR. WETZEL:

10 Q. Dr. Leonard, the -- the last 801(b)(1)
11 factor that you considered was the -- was the
12 disruption factor. How did that factor influence
13 your analysis of -- of the benchmarks?

14 A. You know, again, I looked at Google's
15 proposal, and I looked at, you know, the way things
16 are currently being done. And, again, there aren't
17 enormous changes there.

18 And so from that perspective, I think
19 it's unlikely to be very -- very disruptive. You
20 know, I think it's important for the reasons I
21 mentioned to keep, you know, a percentage of royalty
22 structure. You know, for various reasons, I think
23 it is important to have the minima in there too, and
24 both of those things would be maintained.

25 The minimum that, in Google's case, for

1 instance, has -- has come into play has really been
2 the 80 cent per-subscriber minimum, you know, which
3 would remain at the same level under Google's
4 proposal.

5 So, you know, all of those things, I
6 think, suggest that Google's proposal wouldn't be
7 very disruptive; whereas, you know, shifting
8 substantially to a different kind of structure, in
9 particular, a per-stream or per-play royalty, you
10 know, I think would be changing things around a lot
11 for the Services.

12 And, you know, it's hard to say what
13 would happen exactly, but it certainly would
14 eliminate a lot of the things that are great about
15 the current system in terms of, you know, the
16 payment for access, but then being able to do
17 whatever you want, I think, Services would have the
18 incentive to try to limit usage in various ways,
19 which, you know, would not be good for availability
20 and would be disruptive. It also changes the
21 Services' cost structure around quite a bit.

22 And then, you know, I think there's
23 another, you know, point here, which is the
24 Services, you know, have made certain investments.
25 You know, I don't -- there are obviously no

1 guarantees in life, but one would think they -- that
2 they, in making those investments, were not
3 anticipating that there would be tremendous changes
4 in the structure, particularly perhaps because
5 Phonorecords I and II themselves were very similar.

6 So if you, you know, again, change around
7 a lot, I think that that would not only potentially
8 disrupt things now, but, you know, could cause
9 people to be -- have much more uncertainty about
10 investments, making investments in the space. And
11 that could be -- could be a bad thing.

12 Q. And did the benchmarks that you examined
13 tend to contain percentage of revenue-based
14 royalties or per-play royalties?

15 A. They, you know, again, tend to be a
16 percentage of royalty, again, with some sort of
17 minimum structure and usually the same kind of
18 thing, percentage of TCC and 80 cent per -- in the
19 case of sort of the standard subscription case, 80
20 cents per-subscriber minimum.

21 Q. Why did you reach the conclusion that a
22 shift to a per-stream royalty would -- would be
23 particularly disruptive?

24 A. Well, again, it just changes around the
25 way things work at the level of the service.

1 Instead of paying a percentage of royalty, you're
2 now paying depending on what users actually end up
3 streaming. So given that they pay, you'd actually
4 like them not to stream anything, because then you
5 would make the subscription revenue and incur no
6 cost.

7 So there are going to be incentives to --
8 to limit the amount of streaming that goes on
9 somehow. And, again, that just is contrary to the
10 first factor.

11 And it also make the costs much more
12 uncertain for the Services. Again, if you know,
13 look, I'm going to basically pay a percentage of my
14 -- my revenue, I have a good idea about what my
15 costs are going to be. If it depends on what my
16 users actually do, then there's some uncertainty
17 about that.

18 And, you know, I think the worst outcome
19 of all would be if it suddenly -- instead of having
20 the all-you-can-eat type situation, they go to plans
21 that actually charge users per play. I think that
22 would really -- would be something that would reduce
23 the actual consumption in music quite a bit.

24 Q. Taken all together, how did the 801(b)(1)
25 factors enter your analysis of the comparability of

1 -- of the various benchmarks that you analyze for
2 purposes of your work?

3 A. Well, again, I think it -- it goes to
4 saying we have an existing structure; you know, how
5 different is Google's proposal from that? There are
6 clearly some differences, but I don't think they're
7 big enough to suggest that, you know, it would be
8 disruptive, particularly given that, again, we
9 get -- I guess, somebody gets to do this again in
10 five years.

11 I think for the next five years, Google's
12 proposal is quite a reasonable one.

13 JUDGE STRICKLER: May I?

14 MR. WETZEL: Go ahead.

15 JUDGE STRICKLER: Thank you. In -- in
16 this section where you talk about the disruption
17 factor, factor D, it's paragraph 131 in your amended
18 report, just on the bottom.

19 THE WITNESS: I think I can find that
20 one. Okay.

21 JUDGE STRICKLER: You -- the first
22 sentence in that paragraph, you say, "A further
23 consideration under the 'disruption factor' is
24 whether one service provider may attempt to
25 manipulate the regulatory process to weaken its

1 rival."

2 THE WITNESS: Yes.

3 JUDGE STRICKLER: And then you go on to
4 discuss the pre- -- excuse me -- the per-stream rate
5 structure proposed by Apple. Do you see that?

6 THE WITNESS: I do.

7 JUDGE STRICKLER: But you don't actually
8 do a particular critique of the Apple proposal in
9 your -- in your testimony, do you?

10 THE WITNESS: I don't think at this point
11 I had their, I don't know, final proposal.

12 JUDGE STRICKLER: The disruption that you
13 speak of, does that fall under the rubric of what
14 economists analyze as raising -- the problem of
15 raising rivals' cost?

16 THE WITNESS: Yes, that would be exactly
17 that concept.

18 JUDGE STRICKLER: Is there -- is there
19 any report that you've provided, amended,
20 supplemental, rebuttal, or otherwise in this
21 proceeding, in which you specifically addressed
22 whether the Apple proposal and its per-stream
23 structure constitutes an attempt to raise rivals'
24 costs?

25 THE WITNESS: I think in seeing Google --

1 Apple's proposal, I do address certain aspects of it
2 in my -- the second report.

3 JUDGE STRICKLER: The second one being
4 the amended one?

5 THE WITNESS: No, sorry, the rebuttal
6 report.

7 JUDGE STRICKLER: Rebuttal?

8 THE WITNESS: Right. And, you know,
9 there are certain elements of -- you know, you can
10 calculate what the per-play rate is. And I think
11 then elsewhere I might calculate what the per-play
12 rates are for various Services.

13 So I think you could do that maybe based
14 on the numbers in my report. I don't believe I got
15 into that too much in my rebuttal report.

16 JUDGE STRICKLER: And with regard to your
17 testimony just a moment ago, you said that if there
18 was a transition from a percent of revenue rate to a
19 per-stream rate, were you -- were you referring to
20 the downstream retail market or the upstream
21 mechanical rate that we're talking about here?

22 THE WITNESS: Well, I was first starting
23 off with a change to the mechanical rate. But then
24 I was saying that could actually lead to a change in
25 the way things are charged downstream too, which,

1 again, I think would -- from my perspective as an
2 economist, would not be a good thing.

3 JUDGE STRICKLER: And if I heard you
4 correctly, you -- one of the reasons why you said it
5 wouldn't be a good thing would be because it would
6 discourage the consumption of music, discourage
7 music listening, right?

8 THE WITNESS: Yes.

9 JUDGE STRICKLER: Well, positive market
10 prices always ration and always discourage some use,
11 so the mere fact that it would cause arguably less
12 listening doesn't make it economically
13 inappropriate; it just -- it would be a positive
14 price that rations listening according to people's
15 willingness to pay, ability to pay. Don't we need
16 to know more, not that you haven't talked about, a
17 great deal more in your report, but the mere fact
18 that it creates a higher positive price doesn't ipso
19 facto make it bad; it just makes it a price that may
20 or may not be the price that the market would set?

21 THE WITNESS: Yeah, but I would say the
22 right price to set is the price for access. Let's
23 worry about those things, set the price of access,
24 and then allow people -- again, because, you know,
25 the marginal cost, when somebody is in the service

1 of giving them another stream, is zero. Let's let
2 them do as much listening as they want there. You
3 know, that has very good economic efficiency
4 properties.

5 JUDGE STRICKLER: So it sounds like
6 whenever we come up with these type of issues of --
7 of how to price positively in the market, we're
8 always drawn back, if I understand your testimony
9 correctly, to the -- to the core issue of the fact
10 that the marginal cost of providing the recording,
11 once there is access, is zero, provided there's no
12 -- there's no substitution or opportunity cost?

13 THE WITNESS: Yeah, again, for somebody
14 in the service, once they're in the service, the
15 opportunity cost actually might be negative, you
16 know, to the extent there's some evidence, I think,
17 that people, once they start streaming, they may
18 actually buy PDDs. I don't think that's a huge
19 effect.

20 But, yeah, that's -- that's part of it,
21 that in that kind of situation, you know, the amount
22 of revenue -- so the amount of consumption, the
23 amount of actual revenue that could be generated by
24 the Service and, therefore, also actually the
25 percentage of revenue or, sorry, the royalty, if

1 100 percent is your revenue basis, could end up
2 certainly being higher than in a situation where you
3 charged people for every stream that they -- they
4 incurred.

5 JUDGE STRICKLER: Thank you.

6 MR. WETZEL: I'll pass the witness.

7 JUDGE BARNETT: Thank you. I think this
8 is the appropriate time for us to take our morning
9 recess. We will recess for 15 minutes.

10 (A recess was taken at 10:41 a.m., after which
11 the hearing resumed at 11:01 a.m.)

12 JUDGE BARNETT: Is someone going to
13 cross-examine this witness?

14 MR. JANOWITZ: That would be me, Your
15 Honor.

16 JUDGE BARNETT: Thank you. I should have
17 guessed by this weighty binder there would be
18 cross-examination.

19 MR. JANOWITZ: Yes, yes. It's not that
20 weighty.

21 CROSS-EXAMINATION

22 BY MR. JANOWITZ:

23 Q. Good morning, Dr. Leonard.

24 A. Good morning.

25 Q. Dr. Leonard, you -- you talked a little

1 bit about your background this morning. I'd just
2 like to ask you a couple more questions.

3 A. Sure.

4 Q. Have you ever testified in a case
5 involving music royalties before?

6 A. No.

7 Q. Have you ever written a paper about music
8 royalties?

9 A. No. No, I don't think so.

10 Q. Is this the first engagement in which
11 you've been asked to testify as an expert in
12 connection with music royalties?

13 A. Yes.

14 Q. Now, I'm going to take this a little out
15 of order, but, you know, that's what always happens.

16 When I read your written direct
17 statement, I saw that you were relying on some
18 benchmarks. And if you look at your written direct
19 statement --

20 JUDGE BARNETT: The amended?

21 MR. JANOWITZ: -- page --

22 JUDGE BARNETT: Amended?

23 MR. JANOWITZ: Amended, yes.

24 JUDGE BARNETT: Thank you.

25 BY MR. JANOWITZ:

1 Q. Exactly. This would be -- I'm not sure
2 the page has been changed, but it's -- it's number
3 5, Roman V, on which paragraph 38 begins, which is
4 in the neighborhood of page 23, may still be page
5 23, for all I know.

6 JUDGE STRICKLER: Page 24?

7 MR. JANOWITZ: Thank you, yes.

8 JUDGE STRICKLER: Now you owe me one.

9 MR. JANOWITZ: I know, I know. I
10 appreciate it.

11 BY MR. JANOWITZ:

12 Q. So you -- this is the heading. It says
13 benchmark analysis for the rates and terms for the
14 Section 115 compulsory license. Then it says "A,
15 continuation of the current rates in Section 385,
16 Subpart A -- physical -- physical Phonorecord
17 deliveries, permanent digital downloads and
18 ringtones." So that's one benchmark, right?

19 A. Well, this is one set of things I
20 considered. As I mentioned, I don't think ringtones
21 are ultimately a very good benchmark, but it's --

22 Q. Sure, I get that. But this is -- this
23 describes one of your benchmarks?

24 A. Yeah. I mean, at a high level, yes.

25 Q. And then you describe another benchmark a

1 few pages later. It's where paragraph 47 begins.
2 It's B, my page has so many notes on it the page
3 number is obliterated. But it says "existing
4 agreements involving licenses to mechanical rights
5 and musical works for digital interactive music
6 streaming services."

7 And so you take that group of -- of
8 agreements and that's your other benchmark, correct?

9 A. Again, this, I would say, is a set of
10 things I've looked at.

11 Q. Yeah, I said it's -- it's a bunch of
12 agreements?

13 A. Yes, it is.

14 Q. Yeah. So, generally speaking, there are
15 two benchmarks. When you were testifying earlier
16 and looking at your slides, I'm seeing reference to
17 Phonorecords I and II, and I also recall -- you can
18 see that on your slide 5, for example. And I recall
19 some testimony regarding the 2012 settlement. I
20 don't know if you remember that. It was
21 particularly a discussion you had with Judge
22 Strickler.

23 A. Okay, yes.

24 Q. And -- and, frankly, I was a little
25 confused, and I'm trying to understand it better. I

1 -- I recall that Dr. Katz based his benchmark on the
2 2012 settlement. Are you familiar with his report?

3 A. At some level, yes, not the details,
4 perhaps.

5 Q. Sure. Perhaps you can recall that that's
6 what he did and we had quite a bit of testimony on
7 Monday concerning the suitability of the 2012
8 benchmark.

9 A. Okay.

10 Q. But you're not -- you're not relying on
11 the 2012 settlement as a benchmark in this case, are
12 you?

13 A. Well, I think, again, it has that
14 structure, and I mean, I think if you look at page
15 47 of my report, I do talk about Phonorecords II
16 supporting the rate structure proposed by Google, at
17 the very bottom of page 47.

18 Q. But when you -- when you refer to your
19 benchmarks, that's not, you know, in the -- when you
20 introduce them and the heading and so forth, that's
21 not what you're primarily relying on, is it? I'm
22 not saying that it's irrelevant.

23 A. Yeah.

24 Q. I'm not saying you can't mention it. I'm
25 just saying that doesn't seem to be how your report

1 is constructed. Isn't that correct?

2 A. I -- yeah, I would -- I would say that
3 the way I, you know, talked about agreements was,
4 you know, the -- the Subpart A settlement, the
5 existing Google agreements. You know, I clearly
6 mention Phonorecords II. I wouldn't say it's as
7 central to what I'm doing, perhaps, as it might be
8 to other people, but, you know, I can't -- I
9 haven't, again, looked with that question in mind at
10 what Professor Katz was doing.

11 Q. Okay. Because I just -- I'm just trying
12 to understand how your testimony works.

13 A. Sure.

14 Q. So I'd like to focus on -- on your
15 proposal for Subpart B under -- Google's proposal
16 for Subpart B. Google has a proposal for Subpart C
17 too, doesn't it?

18 A. It does.

19 Q. But to the best of my recollection, I
20 didn't see that addressed today.

21 A. I did not go through every, you know, if
22 you'll call it category under which -- under B and C
23 for which -- I think Google has a proposal for each
24 category.

25 Q. Correct. But you didn't go through C at

1 all today, correct?

2 A. I did not go through C, that's correct.

3 Q. That didn't -- that didn't show up.

4 A. It did not.

5 Q. But you did reference C in your report,
6 correct?

7 A. Yes, I believe so.

8 Q. Okay. So trying to be responsive to your
9 testimony, I will focus on B. And that is for
10 standalone portable subscriptions mixed use, which
11 is, I think, probably the first demonstrative --
12 maybe it's the second demonstrative in your binder.
13 It's in your second demonstrative.

14 In any event, I have one as well. And if
15 you look in your binder, you know, just for a
16 starting point, if you -- if you look at
17 demonstrative 1, I think, you'll see a chart that we
18 have all become very familiar with.

19 A. So when you say my binder, you mean the
20 cross binder?

21 Q. Correct.

22 A. Okay, sorry, yeah. All right.

23 Q. So, hopefully, there's a tab in there.

24 A. There's -- actually, it seems to be
25 slipped in here.

1 Q. Good enough.

2 A. But it's demonstrative 1, yes.

3 Q. Okay. Great. So just to have a starting
4 point, that's -- that's what the current regulation
5 is, correct? That's what the current calculation
6 is?

7 A. Let's see. I believe that's right, yes.

8 Q. Okay. And Google's proposal is the
9 greater of 10 and a half percent of service revenue
10 and the lesser of 13 and a half percent of the total
11 amount paid for sound recording rights or TCC, which
12 is a term you're comfortable with, correct?

13 A. Yes.

14 Q. And the existing per month minima set
15 forth in the current regulation, which is 80 cents
16 per subscriber per month, correct?

17 A. Correct.

18 Q. So that's your proposal. You were also
19 proposing, or Google is also proposing, that the
20 resulting royalty pool would be subject to a
21 deduction for payments made for public performance
22 rights, correct?

23 A. Correct.

24 Q. That's not a change from the existing
25 regulation?

1 A. I think that's right.

2 Q. And Google is also proposing that when
3 you calculate revenues, so that what goes into that
4 very first part A calculation of 10 and a
5 half percent of music service revenue, that there be
6 a deduction of 15 percent of revenue for certain
7 costs of revenue such as app store fees, credit card
8 transaction fees, and carrier billing rates. Is
9 that right?

10 A. Yes, I think you read that correctly.

11 Q. And do I understand correctly that you'd
12 probably make that deduction right off the top?

13 A. Well, you make the deduction before
14 applying the 10.5 percent. And then that's what
15 would be in, I guess, what's here is A.

16 Q. Exactly. And, lastly, Google is
17 proposing that the 50 cent mechanical-only floor be
18 eliminated, correct?

19 A. Correct.

20 Q. So I've -- I've accurately described the
21 proposal?

22 A. I believe so, yes.

23 Q. Okay. So in order to compare Google's
24 proposal with the existing calculation, the first
25 thing we do is we deduct the 15 percent of revenue

1 shown in part A, and then -- correct?

2 A. No.

3 Q. No? Okay. Tell me where I'm wrong.

4 A. Well, you deduct what a given Service
5 might have as the applicable categories. As I
6 mentioned for Google, they would be, you know, 1 to
7 3 percent. For another Service, it could be
8 different but --

9 Q. Right.

10 A. So it's not necessarily 15 percent.

11 Q. I got it. So it's up to 15 percent?

12 A. Correct, which, you know, is one input
13 when you say clearly includes the number zero, but,
14 yes, it could be up to 15 percent.

15 Q. Sure, but -- but might more often include
16 the number 15?

17 A. It could if you have enough in those
18 categories.

19 Q. Right.

20 A. But, again, Google would not, for
21 instance.

22 Q. And it presents a sort of an attractive
23 target, doesn't it? If you know that you can deduct
24 15 percent pursuant to the statute, you might look
25 for ways to do it, correct?

1 A. You know, potentially but, again, you
2 have to fit into those categories.

3 Q. Sure.

4 A. In a reasonable way.

5 Q. In a reasonable way?

6 JUDGE STRICKLER: Who would -- who would
7 monitor whether -- under your proposal, whether or
8 not Google, for example, is falling into those cost
9 categories in a reasonable way?

10 THE WITNESS: I think it's probably a
11 legal question. I'm not maybe the best person to
12 answer, but I imagine there's some sort of
13 enforcement mechanism in general. I don't know that
14 that's the case, but, you know, in general, you
15 would hope there was some sort of enforcement
16 mechanism to -- you know, that people could
17 adjudicate disputes.

18 JUDGE STRICKLER: Let's stay in your
19 ballpark. Let's stay in the economics ballpark.
20 Isn't there a problem generally when you have -- in
21 the somewhat analogous of field rate regulation,
22 when there's -- when there's a question of including
23 costs to determine the appropriate rate of return,
24 that the -- that the calculation of costs becomes
25 problematic because there's an issue of raising

1 costs to reduce the -- the utility rate?

2 THE WITNESS: There is, but I think
3 that's because there -- there's a lot more
4 ambiguity. I mean, here these are pretty defined
5 categories that I think are well accepted in the,
6 you know, Internet and more generally areas.

7 And so I think it would be hard to make
8 up some new costs and try to pound it into one of
9 these categories. I think it's -- you know, they're
10 pretty circumscribed. But, you know, again,
11 hopefully, there's some mechanism to resolve any
12 kind of disputes that would arise.

13 JUDGE STRICKLER: You wouldn't have to
14 make up a new cost; you could just inflate an
15 existing cost, correct? Pay more than you otherwise
16 will, knowing that you'll get a rate benefit out of
17 it?

18 THE WITNESS: I mean, the problem is --
19 let's take something like credit card costs. I
20 mean, if you're Google and you go to the credit card
21 company, you know, I think it would be hard to argue
22 for a different rate for the subscription payments
23 than for other things. And you certainly don't want
24 to raise your rates for credit card expenses on
25 other things that you're doing.

1 So, you know, is it possible? I -- I
2 suppose. And as usual, maybe some sort of
3 benchmarking analysis could be used to make sure
4 somebody isn't doing that, but I don't view that as
5 too much of a concern.

6 JUDGE FEDER: Let's take app store fees
7 as an example. Google Play is effectively an app
8 store. Do they impute an app store fee to their
9 sales of music in order to reduce the amount of
10 revenue subject to the royalty?

11 THE WITNESS: I don't know. I'd have to
12 go back and look at how that -- that works and what
13 they're doing. You know, look, I would certainly be
14 -- it would be a concern, I think, if somebody -- if
15 you look and see somebody changing the way they're
16 doing something after -- after a regulation like
17 this changed. I mean, that would be something --
18 again, if I were somebody receiving the royalties, I
19 might say: Wait a minute, you know, we need to look
20 more deeply at that.

21 So I don't know enough about the
22 specifics to how that could possibly work to be able
23 to really tell you.

24 JUDGE FEDER: Okay.

25 BY MR. JANOWITZ:

1 Q. Dr. Leonard, still on the 15 percent
2 cost, you've said today and it's in your report that
3 the credit card fees are fairly small, between 1 and
4 3 percent, correct?

5 A. Yeah, I mean, credit card fees typically
6 are that level.

7 Q. Right. There are certainly a lot of
8 these -- these subscriptions are sold through the
9 app stores, correct?

10 A. Again, I would have to look at the
11 details of how the subscriptions are -- are done.

12 Q. Do you know whether or not subscriptions
13 are sold through app stores?

14 A. Well, again, if you're saying -- I'd have
15 to look at how -- for instance, Google Music, does
16 it count that subscription as going through the app
17 store in the same sense that other things go through
18 the app store? That I'm not quite sure of.

19 Q. That's a -- that's a different issue.
20 That's -- that's whether Google puts on a charge for
21 its own app store but it sells --

22 A. Right.

23 Q. I get that. But there are other
24 subscriptions; for example, Spotify.

25 A. Right.

1 Q. You can get Spotify from the Apple --
2 from iTunes, correct?

3 A. Yeah. I -- again, I'd have to go back
4 and check the details, but I think there were some
5 issues about they -- Spotify trying to move out of
6 that situation so they didn't have to pay those app
7 store fees.

8 Q. But that indicates that, in fact, those
9 fees have been paid?

10 A. Yes, it's possible Spotify paid those
11 fees.

12 Q. And also others may well have paid those
13 fees?

14 A. It's possible.

15 Q. Do you know what those fees are?

16 A. I haven't looked at what the Spotify fees
17 are that I can recall. I'm afraid I can't give you
18 an answer on that.

19 Q. Do you know whether or not they are
20 substantially in excess of 1 to 3 percent?

21 A. Again, I would have to go back and look.
22 I wouldn't feel comfortable giving you a yes or no
23 on that.

24 Q. So sitting here, do you have any sense,
25 if we had 15 percent as sort of the maximum, what

1 the likelihood is that we'd reach that maximum?
2 What the -- have you valued the components that
3 would go into that to give us a sense of whether or
4 not we're talking about 3 percent, 5 percent,
5 8 percent, or 15 percent?

6 A. Again, I've done it for Google in the
7 sense that my understanding is that it would be
8 limited to the credit card fees. For other
9 Services, I haven't looked at the details of that.

10 Q. Well, what you're saying is it's 1 to
11 3 percent for credit card fees. But what about the
12 other things? Because you're asking that other
13 things also be permitted to be deducted. So I'm
14 asking you have you valued and calculated what those
15 other things are and how much of the 15 percent
16 potential they would absorb?

17 A. And I'm saying for Google, there wouldn't
18 be any others, as I understand. It for other
19 Services, I can't say one way or another because I
20 haven't analyzed those other Services.

21 Q. Okay. So continuing in the changes to
22 the existing calculation, in item 2 -- and you
23 actually show this in a chart that's kind of helpful
24 in your presentation -- you -- you would change the
25 TCC, which is currently either 21 percent or

1 17.36 percent, and you would change that to a single
2 number, 13 and a half percent, correct?

3 A. Yeah. I mean, I should say I think the
4 reason there are two different numbers is it depends
5 on whether it's being applied to sound recording
6 payments before or after the -- certain things have
7 been removed, so that the 13.5 percent would
8 correspond to the 21 percent.

9 Q. That's what I was getting at. So -- so
10 it's a -- it's a diminution, not from 17.36 percent
11 but from 21 percent to 3 and a half -- 13 and a
12 half percent, correct?

13 A. That's -- that's correct.

14 Q. All right. And, of course, we eliminate
15 the mechanical-only floor.

16 So with respect to your reliance on the
17 Subpart A settlement, you provide an analysis, which
18 is your Exhibit 7 to your written direct statement,
19 which calculates -- let's take a look at it -- do
20 you have your -- do you have that from your --

21 A. Yes, I do. It's also stuck in the --
22 slipped in here.

23 Q. Let me see if I can find it. Okay. It's
24 your amended Exhibit 7, right?

25 A. Yes.

1 Q. Okay. And there are the two -- two forms
2 of it, which basically have the same numbers, it
3 would appear, but in the second one, you -- you
4 know, you highlighted a box on the price per song.
5 So then we'll -- we'll look at that one.

6 A. Okay, sure.

7 Q. All right? So what we have here is a
8 calculation based upon the royalty under Subpart A,
9 correct?

10 A. Yeah. I think -- I don't actually have
11 my demonstratives here in front of me, but I can do
12 it off of the exhibits.

13 Q. Do we have a demonstrative ourselves?

14 A. I do have Exhibit 7, so as long as it's
15 just -- yeah, we can put it up here. That's good
16 too.

17 Q. Is that the amended 7? I'm asking if our
18 demonstrative is the amended 7. It's a bit of a
19 problem.

20 I think we're safer using your exhibit.

21 A. Okay.

22 Q. If you don't mind.

23 A. Yeah, no, it's fine with me.

24 Q. Exhibit 7 as amended.

25 A. Yeah, I've got it, actually, because I do

1 have the amended report.

2 Q. Right.

3 A. -- in this binder here. So if I go to
4 Exhibit 7, I should be good. Okay.

5 Q. So we have a mechanical royalty rate
6 here, which is fixed by statute and which doesn't
7 change over time, correct?

8 A. Yeah, I mean, the structure of it, again,
9 because if one year they're longer songs --

10 Q. I understand. But subject to the fact
11 that there are longer songs and shorter songs --

12 A. Yes.

13 Q. -- it doesn't really change.

14 A. That's correct.

15 Q. So the -- what you're focusing on here is
16 the relationship between the royalty under the
17 statute and the price per song. And what you're
18 observing, if I understand you correctly, is that
19 the price per song from 2006 goes up to \$1.10 in
20 2015, as a result of which you calculate that the
21 effective per song royalty is declining.

22 A. That is the result, yes.

23 Q. Okay. And if we look at the -- the last
24 line, you'll see that that effective rate goes from
25 9.6 percent in 2006, then it stays at 9.6 through

1 2008, and then it declines to 9.3, then to 8.8, then
2 to 8.7, then to 8.6, then to 8.5, and then in 2014,
3 it goes up to 8.8 percent. Then at 2015, it's down
4 a percentage, although it's higher than it was in
5 2013 and 2012 and as high as it was in 2011. Do you
6 see that?

7 A. I do.

8 Q. So did the -- nothing has happened to the
9 royalty rate, the actual -- not the rate, but the
10 royalty as fixed by statute during this time,
11 correct?

12 A. Yeah, basically, that's correct.

13 Q. So -- so the Copyright Owners are on this
14 ride up and down, as we can see from your Exhibit 7,
15 through no volition of their own; isn't that right?

16 A. Well, I mean, it's mainly down. You
17 know, there's obviously variation in the price for,
18 you know, the weighting between albums and singles
19 and whatnot. But, yeah, it has been down over time,
20 that's right.

21 Q. It has been down and it has been up?

22 A. Again, you know, it's a -- I'd say things
23 bounce around a bit, but it's definitely headed down
24 over time and continues to be in 2016.

25 Q. But -- but you -- you recognize that it

1 has gone up on occasion from year to year?

2 A. Yes, and the numbers have gone up on
3 certain occasions, but, again, the trend is down.

4 Q. And so -- and so whether it goes up --
5 whether the average effective number goes up or
6 whether it goes down has nothing to do with anything
7 that the Copyright Owners do, does it?

8 A. Well, but, I mean, you know, in an
9 apportionment situation, I can be providing a
10 certain piece of things and what other people are
11 providing can affect my apportionment -- the part
12 that's apportioned to me, and that can certainly
13 happen.

14 Q. Sorry, perhaps you didn't understand my
15 question. What I'm asking you is this calculation
16 that you do at the bottom of your Exhibit 7, where
17 the effective rate goes down, mainly; goes up a bit,
18 that has nothing to do with anything that the
19 Copyright Owners have done or not done, correct?
20 It's math. That's all it is?

21 A. I guess I disagree with that.

22 Q. Well, then tell me how.

23 A. Okay. Because the Copyright Owners have
24 agreed to the 9.1 cents, you know, and the rest of
25 the Subpart A structure as time has gone on. So

1 it's certainly as a result of something they've
2 done. They've agreed to that particular number,
3 knowing, again, what's -- what has happened over
4 time and, frankly, what's expected to happen in the
5 future.

6 Q. Well, are you telling me that they have
7 the right to opt out if they should decide -- if
8 they should perceive that the rate, that the
9 effective rate is declining?

10 A. I'm telling you that they settled for the
11 9.1 cents as recently as 2016.

12 Q. But your chart doesn't go to 2016. It
13 covers 2006 to 2015.

14 A. Correct.

15 Q. And so I'm asking you, very simply, it's
16 really a simple question, whether the -- the
17 percentages that you show here are anything that
18 during the time that the statute was in effect, the
19 Copyright Owners had any control over?

20 A. I mean, again, I would -- would just
21 reiterate my answer, that I think they had input
22 into the 9.1 cents. You know, they had control over
23 their actions as deciding, for instance, you know,
24 whether to litigate something, how to litigate that
25 -- that thing, whether to settle. And my

1 understanding is that -- you know, that, obviously,
2 certain decisions were made and we end up with the
3 9.1 cents continually throughout time.

4 That didn't just happen. It happened in
5 part because of decisions on the part of Copyright
6 Owners.

7 Q. All right. I don't want to waste any
8 more time on this point.

9 If the price of downloads declined during
10 this period of time because downloads fell out of
11 favor with the consumer, the copyright owner would
12 still get 9.1 cents per PDD; is that correct?

13 A. If the price of PDDs had fallen, then
14 that certainly would, again, be -- well, and the
15 same 9.1 cents had been agreed to, then that would
16 be the math, but, you know, maybe the 9.1 cents
17 wouldn't have been agreed to in that event. That's,
18 of course, not what really happened. And so it's
19 not a concern, I think.

20 Q. So -- but we're not dealing with a
21 hypothetical here, right? We're dealing with what
22 actually occurred in the period from 2006 to 2015?
23 You're putting this forth as real data, correct?

24 A. This, yeah, I mean, and no disrespect
25 intended, but, I mean, you asked me if prices of

1 PDDs had fallen. That is a hypothetical because,
2 you know, again, you're right in the sense that
3 there were times when it went down a little bit,
4 but, you know, the overall trend is clearly --
5 sorry, it went up a little bit, but the overall
6 trend is -- sorry.

7 The overall trend is upward. There were
8 few, occasional situations where it went down
9 because of the -- the weighting really.

10 Q. Dr. Leonard, the -- the price of PDDs
11 under Subpart A, that's a unit price, is it not?

12 A. The price for a PDD is the price for a
13 PDD. That's correct.

14 Q. Right.

15 A. And if your definition of unit is the
16 download itself, not -- not clearly the play of that
17 download.

18 Q. Sorry, I didn't -- I didn't quite hear
19 you.

20 A. It's not a price per play of the
21 download. It's a price for the download itself.
22 And then --

23 Q. Right.

24 A. -- the user is free to play it as many
25 times as the user would like.

1 Q. Right. But at the point where it's being
2 sold to the user, it's being sold on a unit basis,
3 correct? Unit being the download.

4 A. Yes, the price is paid for download, and,
5 you know, on the subscription price, the price is
6 for a subscriber. And, you know, those are the two
7 elements of -- of units in those cases.

8 Q. Does the fact that the PDD is a unit cost
9 or unit price, does that distort the market, in your
10 opinion?

11 A. Well, I would say, first of all, that's
12 a -- you know, again, not as much as a per play
13 would be. If you tried to charge per play on a PDD,
14 I think that would -- I'm not sure I'm going to
15 adopt the usage "distort," but I think that would
16 lead to less consumption of PDDs.

17 By pricing at the level of PDD and giving
18 people, you know, basically unlimited access to
19 listen as much as they want once you -- they
20 purchased the PDD, I think that's an improvement in
21 that sense that you'll get more consumption.

22 And streaming in some sense is the
23 evolution of next step and the evolution of that,
24 which is now we've got -- you know, somebody pays a
25 price for access to listen to the library as much as

1 they want. And, again, I think that's going to lead
2 to more consumption of music by consumers.

3 Q. So I take it that what your answer is
4 that no, the fact that the PDD is a unit price does
5 not lead to distortion with respect to PDDs,
6 forgetting about streaming for the moment?

7 A. I guess, again, it's -- you have to say
8 relative to -- to what?

9 Q. That's not my question.

10 A. Okay.

11 Q. I'm asking you consider it alone.

12 A. But, I mean, distortion means -- that
13 means you have something in mind that's, you know, a
14 but-for situation. It's hard to evaluate that
15 unless you tell me what the but-for situation is.

16 Q. All right. If you can't answer the
17 question, you can't answer the question.

18 The royalties on Subpart B are a
19 percentage of revenue, correct?

20 A. You mean under the current --

21 Q. Under the current.

22 A. Subject to the minima, yes.

23 Q. Yes, okay. So with respect to Subpart A
24 and PDDs, an entrepreneur who has a mechanical right
25 to a PDD can go out and sell it for as much as he

1 can get, correct?

2 A. I'm sorry, sell it to who?

3 Q. To a consumer.

4 A. Sorry, could you restate the question? I
5 think I'm confused as to --

6 Q. If you -- if a PDD is sold, say, on
7 iTunes --

8 A. Okay.

9 Q. -- right? The -- the person who controls
10 the PDD, can set that price, correct?

11 A. Oh, so you mean, sorry, like the retail
12 store selling the PDD --

13 Q. Correct.

14 A. -- can determine the price of that?

15 I think, ultimately, you know, there's a
16 lot of legal issues tied up in all this and there
17 have been various problems, both here and elsewhere.
18 But I think, ultimately, the retailer is supposed to
19 be able to determine the price.

20 Q. And if I had -- if I had my own, you
21 know, retail store, you know, digital retail store,
22 and I had music that I owned, that I controlled,
23 that I was going to sell through the store, I could
24 charge any price that I wanted and I could keep all
25 of the profit, correct? Certainly, as between -- as

1 between me, the -- the retailer, and the music --
2 the Copyright Owners?

3 MR. WETZEL: Objection to form of the
4 question.

5 THE WITNESS: So just to be clear, so
6 you're saying you're the retailer selling PDDs.
7 You've obtained the necessary rights.

8 BY MR. JANOWITZ:

9 Q. Mechanicals, exactly.

10 A. Okay. And I take it the sound recording
11 rights and whatever else you would need.

12 Q. Let's assume I have those too.

13 A. Okay. And your question is simply at
14 that point, I could charge as much as I wanted to
15 for the PDD? I mean, you know, I don't know whether
16 there are -- in those kind of agreements, whether
17 there can be, you know, restrictions on the price
18 that are paid at -- in other words, that can be
19 charged at retail, some sort of retail price
20 maintenance system --

21 Q. Assume there are none.

22 A. There are none, okay. So if there are no
23 legal constraints, then I think by definition the
24 retailer would be free to set whatever price they
25 wanted to.

1 Q. Right. And whatever profit that I as the
2 retailer would realize would be mine to keep; I
3 wouldn't have to share it with the Copyright Owners
4 who I got the mechanical royalty -- license from,
5 correct?

6 JUDGE STRICKLER: Are you talking about
7 under the Subpart A per unit?

8 MR. JANOWITZ: Subpart A, exactly, Your
9 Honor.

10 THE WITNESS: Assuming you've already
11 reached some sort of agreement with the rights
12 owners, you know, that already establishes the way
13 things are going to be shared, so whatever is left
14 over after that would be -- you know, again, subject
15 to whatever other obligations you have, I would
16 imagine would be the retailer's to keep, if that's
17 your question.

18 BY MR. JANOWITZ:

19 Q. Right. On the other hand, in the Subpart
20 B regulation as it exists and as Google proposes
21 that it continue, the streamer who is providing
22 access to the streams to the consumer has to share
23 revenues with the Copyright Owners, correct?

24 A. That's the way the -- again, the royalty
25 is calculated as a percentage of revenue, but,

1 again, you know, this is -- in a way, this is
2 semantics because you -- you know, you can either
3 have -- you can pay royalties in different ways.

4 Q. But I'm talking about the way that it is
5 currently paid under Subpart B. That's a percentage
6 of revenue. So when a dollar comes in, I have to
7 share -- and I'm the streaming company, I have to
8 share that on some basis as defined in Subpart B
9 with the Copyright Owners, correct?

10 A. Again, subject to the per-subscriber
11 minima --

12 Q. Of course.

13 A. -- and other things, but, yes.

14 Q. Okay. So that's different, isn't it,
15 from what goes on in Subpart A, where the person who
16 is selling on the music to the consumer has the
17 ability to recognize and keep whatever profits he
18 can because he doesn't have to share revenues with
19 -- with the people who are giving him the music,
20 right?

21 A. But in -- you know, selling a PDD, of
22 course, you're going to take into account the costs
23 that you're going to incur when you -- when you do
24 that, just like when somebody decides what price
25 they're going to charge for streaming, they're going

1 to take account of the fact that there's some
2 percentage of royalty that they're going to have to
3 -- to give up. So, I mean, the considerations are
4 similar.

5 Q. But when you --

6 JUDGE STRICKLER: Excuse me --

7 MR. JANOWITZ: I'm sorry, Your Honor.

8 JUDGE STRICKLER: May I?

9 MR. JANOWITZ: Of course.

10 JUDGE STRICKLER: Isn't one of the
11 differences between the Subpart A structure and the
12 Subpart B structure, beyond what we're talking about
13 now but as a necessary result of what we're talking
14 about now, a difference in the risk that's faced by
15 the copyright owner? The copyright owner under
16 Subpart A faces a risk in the change of quantity
17 sold downstream -- greater quantity, greater sales
18 per unit, more money; fewer sales, less money --
19 whereas under Subpart B, the risk is a revenue risk?
20 What is total revenue going to be? Are you going to
21 have more or less subscribers? Are you going to
22 have a higher or lower price per subscription, which
23 will impact revenue?

24 So when you make the comparison of
25 Subpart A to Subpart B, wouldn't it be necessary

1 from an economic point of view to analyze what the
2 difference is in the risk that's faced by the
3 copyright owner? And maybe "risk" is not quite the
4 right word; maybe it's the variance or the deviation
5 that they face in terms of return now that they've
6 exchanged one risk for another?

7 THE WITNESS: I mean, what's interesting,
8 though -- I mean, so if I reduce my price a little
9 bit or let's say -- sorry, let's say I increase my
10 price a little bit, the quantity goes down, right?
11 Revenue actually is going to change somewhat less
12 than that in some sense because the -- the higher
13 price offsets the lower quantity.

14 So I think it's a somewhat -- I mean, you
15 could do this. It doesn't seem to me that it's
16 going to matter a huge amount. And, you know,
17 percentage of revenue royalty structures I would say
18 are -- in my experience in IP licensing, are, you
19 know, obviously very prevalent and probably the most
20 prevalent method.

21 JUDGE STRICKLER: Are there particular
22 aspects of a -- of a market for intellectual
23 property downstream that make a percentage of
24 revenue approach more or less appropriate upstream?

25 THE WITNESS: You know, I think if there

1 are concerns about, you know, big changes occurring
2 in the marketplace, sometimes that leads to
3 gravitation towards a percentage royalty, but I
4 think it really can vary a lot in circumstances, and
5 it's hard to, I think, have a bunch of -- small set
6 of rules that would tell you which way one would go
7 versus the other.

8 JUDGE STRICKLER: Have those factors that
9 influence whether or not you have a personnel of
10 revenue royalty rate upstream -- those factors that
11 exist in the downstream market, have they changed
12 from the 2012 settlement to today?

13 THE WITNESS: I -- I don't believe so,
14 no.

15 JUDGE STRICKLER: Thank you.

16 BY MR. JANOWITZ:

17 Q. Dr. Leonard, the observed decline in the
18 effective royalty per play would not be observed
19 under the current Subpart B structure because
20 streaming royalties are paid on the basis of
21 revenue, correct?

22 So in your example, the increase in the
23 price of music to the consumer would actually result
24 in higher revenues to the Copyright Owners under
25 Subpart B? Is that correct?

1 A. Well, two things. I mean, one is the
2 higher revenue per unit but not necessarily higher
3 royalties overall because, you know, increase in
4 price may be leading to a decline in -- in
5 quantities, as we were just talking about. So it
6 would -- it would depend.

7 And then, secondly, I mean, again, I
8 think you can't assume that the 9.1 cent royalty was
9 set in a vacuum. I mean, it was set knowing facts
10 such as that, you know, PDD prices have gone up and
11 it's not too surprising that they would continue to
12 go up, and yet the Copyright Owners have agreed to
13 that structure in 2016.

14 So I think you have to take the whole
15 thing considered together and say there's an
16 implicit acknowledgment there that in this
17 percentage of royalty terms, when you converted it
18 to that, that the musical work is getting a smaller
19 percentage or is entitled to a smaller percentage of
20 that today than it was perhaps earlier on.

21 Q. Take a look at your amended Exhibit 7
22 again, which covers 2006 through 2015. If I was a
23 -- an owner of mechanical rights in 2006, I would
24 see -- presuming that this price per song were
25 evident in the market, I would see a price of 99

1 cents for the price per song as it was sold to the
2 consumer, correct?

3 A. That's correct.

4 Q. And in 2007, if I looked at the market
5 again, I would see that it was still 99 cents,
6 wouldn't I?

7 A. You would.

8 Q. And if I looked at it again in 2008, I
9 would see that it was still 99 cents, correct?

10 A. That's what it would say, yes.

11 Q. Okay. And so, as the rights owner, I
12 have limited vision. I can see what's going on
13 around me, correct?

14 A. Well, I mean --

15 Q. Put another way, would I know, would I
16 have a way of knowing, that in 2009, these records
17 would be selling for \$1.03?

18 A. You may very well. I mean, there's
19 people --

20 Q. Tell me how I would know that.

21 A. Well, people do market analysis all the
22 time to have a sense of what's going to happen in
23 the future. But I mean, the other thing is by 2016,
24 they clearly know prices are, you know, at \$1.10, or
25 I think they've gone up a little bit more since

1 then.

2 Q. That's not a question I asked you,
3 Dr. Leonard.

4 A. Okay.

5 Q. Thank you. Dr. Leonard, you didn't use
6 this observed decline in the effective royalty rate
7 per song to arrive at the Google proposal, did you?

8 A. To arrive at the Google proposal?

9 Q. Correct.

10 A. I did not, no.

11 Q. And to your knowledge, Google didn't use
12 this analysis to arrive at a rate either, did it?

13 A. I can't say I know exactly how Google
14 arrived at its proposal.

15 Q. Do you know anything about how Google
16 arrived at the proposal?

17 A. No. I mean, I don't know what was in the
18 minds of whoever at Google signed off on the
19 proposal.

20 Q. And, In fact, with respect to the
21 percentage of revenue headline rate, the 10 and a
22 half percent, Google is proposing that it remain the
23 same and notwithstanding the analysis you did in
24 Exhibit 7, and you are supporting that proposal,
25 correct?

1 A. That's correct. Well, in the sense that
2 I think that that's reasonable in light of such
3 things as Exhibit 7.

4 Q. Right. So the purpose of the calculation
5 is to support an argument that if you compare
6 the percent of revenue received by the Copyright
7 Owners under Subpart A to the headline right -- rate
8 under Subpart B, the owners are well served by the
9 10 and a half percent of revenue, correct?

10 A. You know, I don't -- I think what I'm
11 looking at is that a reasonable rate in light of the
12 801(b)(1) factors, if what you mean is that
13 represents -- together with the minima, represents,
14 you know, a reasonable compensation for the
15 contribution of musical works, then I'd say yes to
16 that.

17 Q. Now I'd like to talk to you a little bit
18 about the factors which should be present in a
19 suitable benchmark. I've looked at your report, and
20 that's really what I'm working off, primarily, other
21 than the slides today --

22 A. Sure.

23 Q. -- which overlap. In paragraph 47, page
24 30, and I'm hoping that's amended version, I think
25 it is, you say that an agreement which is negotiated

1 -- and I'm going to give you these -- these as
2 factors that you considered --

3 A. Sure.

4 Q. -- as -- as leading to a suitable
5 benchmark. One is the absence of any constraints in
6 the -- in the negotiation, correct?

7 A. Yes.

8 Q. In an arm's-length negotiation, correct?

9 A. Yes.

10 Q. Negotiated in the open market, correct?

11 JUDGE STRICKLER: Which paragraph are you
12 on?

13 MR. JANOWITZ: I'm hoping I'm looking at
14 paragraph 47. I will take a look and make sure that
15 that's the case.

16 THE WITNESS: Yeah, it is 47, at least
17 the first two. Okay. I see the third one too.

18 BY MR. JANOWITZ:

19 Q. Okay.

20 A. Yeah, I think that is -- yeah, that's
21 there.

22 Q. Yes, it's in the section -- oh, you've
23 got it, okay.

24 And what you say is that these factors,
25 if present, can potentially be used to form a

1 benchmark, correct?

2 A. That's right.

3 Q. Not necessarily, but potentially,
4 correct?

5 A. Correct.

6 Q. Okay. In addition, at paragraph 73, page
7 46, when talking about using existing deals as
8 benchmarks, you rely upon the following factors.
9 Are you with me?

10 A. Let's see. Sorry, 73? Page 46? Yeah,
11 I'm -- I'm there.

12 Q. So that one is that they involve similar
13 parties. Another is that they're -- they are
14 similar services. And similar rights to those in
15 the 115 license. So let's take a look at Subpart A
16 -- Subpart A settlement in light of those standards.

17 In the case of the Subpart A settlement,
18 there were constraints on the Copyright Owners,
19 weren't there? In other words, the Subpart A
20 settlement was made in the shadow of the compulsory
21 license, correct?

22 A. Well, I think as far as constraints, I'm
23 talking more about in this -- when I mention that as
24 far as market power and holdup and that kind of
25 thing.

1 I mean, since one of the points here is
2 to get to a result that's consistent with the
3 801(b)(1) factors, to the extent that that played a
4 role in the settlement in 2016, that would be a
5 positive from my point of view. So that's not a
6 constraint in the sense I was referring to in that
7 earlier paragraph.

8 Q. Well, let's see if we can get on the same
9 page in terms of what a constraint means.

10 A constraint is simply something that
11 acts as a force on something else, right? It holds
12 something back or limits somehow the action of
13 somebody to do something. Is that a fair statement
14 of what a constraint is?

15 A. Well, there could be a distinction here
16 between, though, a general definition of constraint
17 and what I had in mind when I was writing this. So,
18 yes, I would say your description probably fits a
19 dictionary definition, but what I was talking about
20 are things like, you know, get market power and
21 holdup and things like that, that you would want to
22 read out in order to make sure that an agreement
23 reflected the appropriate relative contributions of
24 the parties.

25 Q. Well, I'm not -- I'm not necessarily

1 asking what you were thinking about --

2 A. Okay.

3 Q. -- as a constraint. I'm asking you
4 whether you would agree that the existence of the
5 statutory rate and the shadow thereof is a
6 constraint on bargaining with respect to a Subpart A
7 deal?

8 A. Well, so the settlement of the Subpart A
9 in 2016, I think it's -- certainly the parties would
10 have contemplated what would have happened, had the
11 proceeding gone through to the end, that that would
12 have been a -- played a factor in the negotiations.
13 But, again, from my perspective, that's a positive.

14 Q. Well, I understand constraints can be
15 positive or they can be negative. If somebody is
16 about to jump off a railroad platform in front of a
17 train and I stop them, that's a good thing. Right?

18 So I'm not -- I'm not -- I would hope --

19 A. Yes.

20 Q. So I'm not trying to inject value into
21 constraint at this point. I'm just trying to
22 understand how the parties are functioning. So
23 getting back to the statutory rate and the shadow of
24 the compulsory, you would agree, would you not, that
25 that would have an impact on the Copyright Owners'

1 negotiation of a settlement?

2 JUDGE STRICKLER: Is that a different
3 question you're asking him now as to whether or not
4 the shadow is a constraint or whether the shadow is
5 an impact?

6 MR. JANOWITZ: Impact and constraint, I'm
7 using -- they are not synonymous, but I'm using them
8 within the same question. In other words, I believe
9 it was a constraint, and that it had an impact.

10 So --

11 JUDGE STRICKLER: You believe it was a
12 constraint. If the witness --

13 MR. JANOWITZ: And I'm asking -- I'm
14 asking the witness.

15 JUDGE STRICKLER: If the witness doesn't
16 -- treats them as interchangeable, then I --

17 MR. JANOWITZ: Sure.

18 JUDGE STRICKLER: -- then I'll understand
19 the back and forth.

20 BY MR. JANOWITZ:

21 Q. Sure. I -- if you have a problem with my
22 using impact and constraint perhaps alternatively,
23 let me know. But if we put aside, you know,
24 constraint perhaps, because that's not the word you
25 were thinking about, that's not the way you were

1 thinking about the word "constraint," are you -- do
2 you -- do you agree that the existence of the
3 statutory rate and the shadow of it had an impact on
4 the Copyright Owners in their negotiations?

5 A. And we're talking now about the Subpart A
6 settlement --

7 Q. Correct.

8 A. -- in 2016? Well, I don't think the
9 existing rate necessarily did. What had a, you
10 know, constraint was that -- or what would have an
11 impact, I guess, potentially, is the concept if we
12 don't reach agreement, we're going to go into this
13 proceeding and a rate will be set according to the
14 801(b) factors.

15 Q. And would that have an impact?

16 A. It certainly could. I mean, I think if
17 you're the -- either party, you're not -- you're
18 going to say, look, we're not going to eventually
19 prevail if we offer some sort of setup that's -- I
20 mean, in the negotiation, if we offer some sort of
21 setup that's really far from where we think things
22 will end up in the rate setting. So that would --
23 that would certainly -- you know, it's -- it's like
24 any time there's a negotiation, if there is some
25 sort of backstop, that backstop can influence the

1 outcome of the negotiation.

2 Again, in this case, from my perspective,
3 that makes it a better benchmark.

4 Q. I understand.

5 JUDGE STRICKLER: Excuse me, counsel,
6 just so we can clarify and link up his oral
7 testimony with his written testimony.

8 Dr. Leonard, do you address the shadow or
9 the constraint or the -- the impact of the statutory
10 license on the negotiated settlement rates anywhere
11 in your direct testimony?

12 THE WITNESS: I -- I would have to go
13 back and -- again, I can't remember everything
14 that's in here versus in other places, but -- so,
15 again, maybe I can check at lunch and let you know.
16 But certainly, I think I said that those things, you
17 know, fell under the rubric of the 801(b)(1) factors
18 and that that -- as does -- you know, as we are
19 here, and that that's a -- you know, something that
20 adds to the usefulness of it as a benchmark.

21 JUDGE STRICKLER: Well, if you notice it
22 at lunch, you know --

23 THE WITNESS: Okay, I shall.

24 JUDGE STRICKLER: -- add it to your oral
25 testimony so we can find it.

1 THE WITNESS: Excellent.

2 MR. JANOWITZ:

3 Q. Talking again about the shadow of the
4 compulsory and the existence of the statute, do you
5 believe that that affects whether or not this is
6 truly an open market transaction, the settlement in
7 2016?

8 A. Well, I think it is -- I mean, it depends
9 what we're talking about here by open market
10 transaction. Again, there can be open market
11 transactions where one party, you know, has a
12 constraint on them so that -- you know, for
13 instance, they are subject to holdup by the other
14 party.

15 You can have an open market negotiation
16 that's affected by that constraint and you end up
17 with, you know, as the concern, standard essential
18 patents that people end up paying royalties that are
19 way too high. So I'm not sure what you mean
20 exactly.

21 Q. Okay. So the fact that there is a
22 constraint does not necessarily change it from an
23 open market transaction?

24 A. Again, it's certainly not -- I think if
25 you go back and read my description there, the open

1 market part was in a different sentence entirely
2 from the constraint part. So, yes, they're not
3 mutually exclusive.

4 Q. So if somebody is bound and gagged and,
5 you know, taken to the conference room to negotiate,
6 and the negotiation is, you know, open to the public
7 and it's maybe even televised, that could well be an
8 open market transaction?

9 A. It sounds to me like there was some
10 illegal activity there. But certainly, you know,
11 somebody who has a -- market power legally, for
12 instance, that's well accepted that that entity can
13 charge whatever price the market will bear.

14 And, you know, that's -- that's the
15 outcome. And I think in -- if the same is true in
16 situations of where it's holdup not created by
17 anything, subterfuge, but just a fact of life, then
18 I think at least in certain settings, the person who
19 has -- can use that as leverage can get a higher
20 price or lower price as the case may be.

21 JUDGE STRICKLER: You just used the
22 phrase "holdup," correct?

23 THE WITNESS: Yes.

24 JUDGE STRICKLER: What -- can you define
25 holdup?

1 THE WITNESS: Yeah. Holdup is when you
2 have two parties and they're thinking about entering
3 a transaction, and one of them has made some kind of
4 investment that's specific to the transaction and
5 that's, you know, irreversible or sunk.

6 And in that kind of case, they have a bit
7 less leverage in the negotiation because they can't
8 undo those -- those costs. If they wanted to, for
9 instance, do something different, they would have to
10 make a different set of specific investments. That
11 leaves them open to, depending on which side they're
12 on, if they're a buyer, of charging -- or being
13 charged a higher price than they would otherwise be
14 able to negotiate.

15 BY MR. JANOWITZ:

16 Q. With respect to the negotiation between
17 the Copyright Owners and the interactive service
18 providers, do you think that the Copyright Owners
19 have market power?

20 A. Sorry, in which negotiation? Just to be
21 clear.

22 Q. The negotiation that will take place in
23 -- a hypothetical negotiation that would take place
24 between the owners, the Copyright Owners, and the
25 interactive streamers with respect to establishing a

1 mechanical royalty.

2 JUDGE STRICKLER: Can I just get a
3 clarification on the question?

4 MR. JANOWITZ: Of course.

5 JUDGE STRICKLER: The hypothetical
6 negotiation that you have in mind, is that between a
7 discrete copyright owner -- a group of Copyright
8 Owners and one streaming service or all Copyright
9 Owners?

10 MR. JANOWITZ: All. Yes, all.

11 JUDGE STRICKLER: So it's an industry --

12 MR. JANOWITZ: Exactly.

13 JUDGE STRICKLER: It's the industry?

14 MR. JANOWITZ: Yes.

15 JUDGE STRICKLER: Okay.

16 THE WITNESS: That -- I wouldn't say
17 that's a question I've specifically analyzed, but I
18 think I would be concerned if a group of Copyright
19 Owners got together to jointly negotiate a price,
20 you know, particularly if they were -- just the
21 mechanical right was being negotiated.

22 BY MR. JANOWITZ:

23 Q. And you would be concerned why?

24 A. Because, potentially, individual works
25 are -- could be substitutes for each other. There's

1 the Cournot complements problem, you know, if one
2 group with market power is getting together and
3 negotiating the mechanical right and some other
4 groups are negotiating the performance rate, you
5 could end up with an overall royalty rate that's too
6 high. It's the royalty stacking problem.

7 Q. Let's look at the -- the parties to the
8 negotiations. With respect -- comparing the Subpart
9 A settlement to the proceeding we're in now --

10 JUDGE BARNETT: Before we get into the
11 parties, --

12 MR. JANOWITZ: Sorry.

13 JUDGE BARNETT: Why don't we take our
14 lunch break. We'll be at recess for an hour.

15 (Whereupon, at 12:01 p.m., a lunch recess
16 was taken.)

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1 AFTERNOON SESSION

2 (1:07 p.m.)

3 JUDGE BARNETT: Good afternoon. Please
4 be seated.

5 Mr. Janowitz, are we continuing with
6 cross-examination?

7 MR. JANOWITZ: Yes, Your Honor.

8 JUDGE BARNETT: I'm sorry, yes, please
9 proceed.

10 MR. JANOWITZ: Thank you.

11 BY MR. JANOWITZ:

12 Q. Good afternoon, Dr. Leonard.

13 A. Good afternoon.

14 Q. At the break I was just about to ask you
15 about the parties to the Subpart A settlement and to
16 this proceeding. They are not the same parties; is
17 that correct?

18 A. I would say the licensor in some sense is
19 the same. The licensee, at least as I understand
20 it, was not or the other counterparty was not.

21 Q. Okay. To be specific, the Copyright
22 Owners, I think when you say licensors, that's who
23 you are talking about?

24 A. Yes.

25 Q. So the Copyright Owners were in both --

1 are in both proceedings?

2 A. Correct.

3 Q. But the counterparties are different,
4 correct?

5 A. That's my understanding, yes.

6 Q. Okay. So in Subpart A, the
7 counterparties were the labels?

8 A. That's my understanding, yep.

9 Q. And the labels are actually licensors of
10 a product or of a right that is a complement to the
11 rights of the, what we refer to as the Copyright
12 Owners, correct?

13 A. Yes. Yes.

14 Q. Okay. And in this proceeding we have the
15 Copyright Owners and we have the interactive
16 streaming services, correct?

17 A. Correct.

18 Q. And they are not in the Subpart A
19 proceeding?

20 A. The streaming services were not, that's
21 right.

22 Q. And with respect to the services that are
23 being offered, and by that I mean the nature of the
24 services, rather than the identity of the people
25 providing it, right?

1 A. Yes.

2 Q. There is -- there is also no congruence
3 with respect to that; is that correct?

4 A. I guess you need to tell me what you mean
5 by the service.

6 Q. In other words, in the Subpart A
7 proceeding, they were setting the royalty for
8 downloads, and in the -- in this proceeding, we're
9 setting rates for a different kind of music service;
10 namely, interactive streaming?

11 A. Yes. So, again, I discussed that, those
12 are the different services, the two services that
13 were at issue in the respective proceedings.

14 Q. Right. And in the Subpart A settlement,
15 that applied to the sale of a single digital
16 download or CD track; isn't that correct?

17 A. The royalty was supposed to be per EDD.

18 Q. And in the Subpart A hearing and
19 settlement, the royalty confers an ownership
20 interest in the person who pays the royalty,
21 correct?

22 A. Sorry, in the subpart --

23 Q. In the Subpart A settlement, the royalty
24 confers an ownership interest, correct?

25 A. I'm not sure what you mean by that.

1 Q. In other words, a PDD is an ownership
2 interest? I think you testified to that this
3 morning.

4 A. Sorry, when you buy a PDD, the consumer
5 has --

6 Q. An ownership interest in the PDD?

7 A. There is some sort of ownership aspect to
8 it.

9 Q. Yes. And with respect to in the -- in
10 the interactive streaming, the consumer does not
11 acquire an ownership interest, correct?

12 A. Yeah, my understanding is not.

13 Q. Okay. Have you done any analysis to
14 determine the relationship between the downloading,
15 downloading a track and having access to a stream of
16 the same music that supports your analysis of the
17 relationship between revenues under Subpart A to
18 revenues under Subpart B?

19 A. Well, I think if you -- if I understand
20 what you are suggesting --

21 Q. What I am asking, Dr. Leonard, if it
22 isn't clear, I am asking if you, Dr. Leonard --

23 A. Yes.

24 Q. -- have performed such an analysis?

25 A. And, again, analysis, just so I have it

1 clear in my head?

2 Q. Of the relationship between downloading a
3 track and having access to a stream of the same
4 music.

5 A. Okay. And do you mean from a legal
6 perspective or any perspective?

7 Q. From -- presumably from the perspective
8 of an economist.

9 A. Okay. So, yes.

10 Q. You have done that?

11 A. Yes.

12 Q. You have done a study?

13 A. Well, I have done an analysis, yes.

14 Q. Have you -- have you included that
15 analysis in your report?

16 A. Again, I don't know to the extent to
17 which things are in this report or the rebuttal
18 report, but I think I certainly discussed why I
19 think they are comparable in important respects.

20 Q. And have you done an econometric study of
21 this?

22 A. I wouldn't say I have done an econometric
23 study, no.

24 Q. Let's take -- let's turn our attention
25 now to the 13 and a half percent TCC that is part of

1 the Google proposal. We're now looking, and if I
2 could direct your attention again to the calculation
3 that is demonstrative 1 of our booklet.

4 A. Oh, okay.

5 Q. And you also might want to look at the
6 demonstrative where you compare them in yours. It
7 is up to you.

8 A. Sure.

9 Q. So Google proposes to replace the TCC
10 prong, which is currently either 21 percent or
11 17.36 percent, depending upon whether there is a
12 pass-through of the mechanical royalty license,
13 correct?

14 A. Correct.

15 Q. And as I think we established earlier,
16 that would be replaced by a single number, which
17 would apply to, I guess, to the 21 percent, but
18 would also apply to the -- to the 13, 17.36 percent
19 too, right?

20 A. No, at least not in my view it shouldn't.

21 Q. Okay. So it applies to the 21 percent,
22 which is if licenses are not a pass-through?

23 A. That's correct.

24 Q. And that's where you would replace the
25 21 percent by the 13 and a half percent?

1 A. Right.

2 Q. Okay. And to be clear for the record, we
3 both understand that the TCC is a measure of the
4 payments by the interactive services to record
5 companies for sound recordings; is that correct?

6 A. That's what the 21 percent is applied to,
7 yes.

8 Q. Right. And that's also what the 13 and a
9 half percent would be applied to, correct?

10 A. Correct.

11 Q. All right. And as I recall, Google
12 proposes to keep the 80 percent -- I'm sorry, the 8
13 cents prong in place, correct?

14 A. The 80 cent prong, yes.

15 Q. Yes, 80 cents. And the 21 percent and
16 the 17.36 percent are sometimes referred to as
17 minima, are they not?

18 A. You know, together with the 80 cents
19 doing the lesser of --

20 Q. Yes.

21 A. -- that creates a minima, yes, minima
22 number.

23 Q. I understand. So the 13 and a
24 half percent would be the new minimum?

25 A. Well, I mean, unless the 80 cent -- 80

1 cents is binding, in which case that would -- the
2 minimum wouldn't change, but, yeah, 13.5 percent
3 replaces 21 percent in this formula.

4 Q. And the 80 cents acts as a cap on the
5 TCC, correct?

6 A. Yes, in the sense that if the percentage
7 of TCC part of this is greater than the 80 cents,
8 then the 80 cents applies.

9 Q. Okay. And this calculation, this prong
10 provides a means by which the Copyright Owners will
11 be protected from a decline of reported service
12 revenue past a certain point; is that correct?

13 A. Yeah, so just holding everything else
14 constant, if revenue, including subscribers' revenue
15 declines, then there will become a point at which
16 the minimum kicks in, yes.

17 Q. Okay. And we know that there is at least
18 one service, for example, that reports zero service
19 revenue, so in that kind of a situation, for
20 example, the minima would be triggered, right?

21 A. I believe there is -- yeah, I mean if
22 there is zero revenues, then you are looking at a
23 different way of figuring out the royalty. And,
24 yeah, obviously this would in that case the -- this
25 prong would apply.

1 Q. Obviously if there was zero revenue, you
2 would default immediately to the B calculation,
3 correct?

4 A. That's -- yeah, I mean, again in this
5 category, that's my understanding.

6 Q. Okay. Do you know how the existing
7 minima of 21 percent and 17.36 percent were selected
8 and calculated?

9 A. I don't think that I have knowledge of
10 what went into that.

11 Q. Okay. These are obviously not whole
12 numbers, so you would think that some process
13 resulted in their selection, wouldn't you?

14 A. I would. I guess I will take back one
15 thing. Given the 21 percent, I know how the
16 17.36 percent was come up with.

17 Q. You mean as compared to the 21 percent?

18 A. Yeah.

19 Q. Yeah, because that's the issue of
20 pass-through.

21 A. You are taking out -- yes, exactly.

22 JUDGE STRICKLER: And how do you
23 understand that amount was calculated?

24 THE WITNESS: So basically 17.36 percent
25 of the sound recording royalties that are kept by

1 the label, plus 21 percent of that same number gives
2 you 21 percent of the sound recording royalties. It
3 is just basically if you are not going to pass it
4 through, the 17.36 percent applied to the
5 non-passed-through number gives you the same as
6 21 percent applied to the sound recording royalties
7 after the pass-through.

8 JUDGE STRICKLER: And what is passed
9 through?

10 THE WITNESS: The sound recording -- I
11 mean, the musical work royalty. So it is kind of
12 circular but, you know, it works out, the math.

13 JUDGE STRICKLER: Performing rights
14 royalty?

15 THE WITNESS: This would be for all-in,
16 so this would be for the total, the all-in royalty.

17 JUDGE STRICKLER: Thank you.

18 JUDGE BARNETT: Let me be sure I
19 understand the Google proposal then. The Google
20 proposal would lower the 21 percent to 13 and a
21 half percent. Would there be a similar calculation
22 to reach a pass-through rate?

23 THE WITNESS: Yes. So if it -- you could
24 -- yes, you could come up with a new percentage that
25 would correspond to 17.36 percent. It would be

1 based on the 13.5. I'm afraid I can't do it in my
2 head, but --

3 JUDGE BARNETT: Okay.

4 THE WITNESS: -- it would be a lower
5 number. That would just be a mathematical
6 calculation.

7 JUDGE BARNETT: Okay. Thank you.

8 BY MR. JANOWITZ:

9 Q. Dr. Leonard, I asked you this morning
10 whether there was another number for the
11 pass-through, and you said no, there is only one
12 number, it is the 13 and a half percent number. Do
13 you remember that?

14 A. Yeah, I said that -- I guess, I guess
15 what I am saying is I think the -- I think what
16 specifies 13 and a half percent, and my
17 understanding of what that is supposed to apply to,
18 is the sound recording payments after any
19 pass-through.

20 So that's why it would -- or if there
21 were no pass-through. So that would be, would
22 correspond to the 21 percent number.

23 If somebody comes along and says: Well,
24 we only have the number before pass-through, then
25 that would have to be a lower number then.

1 Q. So, in other words, even though it -- you
2 would adjust it, even though the proposal as made by
3 Google doesn't provide for pass-through or
4 non-pass-through; is that what you are saying?

5 A. If you want to set it up so that it has
6 both then, yeah, you need a different number. And
7 it is, again, just math to calculate it.

8 Q. I understand. But what I am asking you
9 is what is Google's proposal? Is it just one or is
10 it both?

11 A. We could go back to check. I think what
12 the proposal is is that you apply 13.5 percent to
13 the portion of the sound -- of what the label
14 collects that reflects their sound recording royalty
15 payment, so it is after pass-through.

16 Q. This 13 and a half percent number, it is
17 a completely standalone number, isn't it? It is not
18 an adjustment of what exists today? Is that
19 correct?

20 A. Yes, I would say, right, it comes from
21 Subpart A is as I have described. And then that
22 suggests a particular percentage that should be
23 applied to the sound recording royalty payment. And
24 that's the number I'm proposing or Google is
25 proposing that 21 percent gets replaced with.

1 Q. Yeah. So the 13 and a half percent is
2 calculated based on the current ratio of the PDD
3 royalty to the royalties paid to the record labels
4 for sound recordings, generally speaking; isn't that
5 right?

6 A. Yeah, I guess I should be -- clarify a
7 little bit there. So Google came up with the
8 13.5 percent. My benchmarking was doing what you
9 are suggesting.

10 Q. And you don't -- do you know how Google
11 came up with the 13.5 percent?

12 A. I do not know specifically, no.

13 Q. Did you ask anyone?

14 A. I did not.

15 Q. Was it of interest to you to see how the
16 new proposed rate related to what was, you know, has
17 been in the statute for some time?

18 A. Meaning was it of interest to me to
19 compare 13.5 to 21?

20 Q. Yes, and to understand how that change
21 came about?

22 A. It was certainly of interest to me to
23 compare those two numbers. Well, I guess I should
24 say, it is of interest to me to compare what I got
25 out of Subpart A to the 21 percent.

1 Q. Well, when you use benchmarks, I think
2 you testified that nothing is perfectly comparable,
3 right?

4 A. Yeah, generally speaking.

5 Q. It's a rare thing. So when you have a
6 benchmark, is it not of interest if you are making
7 an adjustment to some existing number to understand
8 the relationship and the derivation between what you
9 are proposing of something new and what has been
10 existing over time?

11 A. I'm not sure I necessarily agree with
12 that. So you could have a number that exists over
13 time, and, you know, it may have come from who knows
14 where. If you have a benchmark that suggests that
15 number is wrong, then the number is wrong, and it is
16 not necessarily of interest why there is a
17 difference.

18 Q. If a number has existed over time, isn't
19 that just -- isn't that a benchmark, and don't then
20 you have to pay attention to it? I am not saying
21 you have to adhere to it, but don't you have to pay
22 attention to it if you are doing a benchmarking
23 analysis?

24 A. Again, it was of interest to me to
25 compare the 21 percent to what I was seeing as

1 Subpart A, and which, you know, were lower numbers.
2 And, you know, one thing that was clear, at least in
3 Google's case, the 21 percent really never binds.

4 So, you know, I think that's another
5 issue with it as far as Google goes, is that it is
6 too -- the 21 percent number is too high to really
7 ever come into play. And in that sense it is not
8 particularly useful.

9 So getting it lower potentially would
10 make it more useful in terms of operating within the
11 structure.

12 JUDGE STRICKLER: Do you know whether the
13 21 percent ever came into play for other Services,
14 other than Google?

15 THE WITNESS: I do not, with the
16 exception of, I believe, Amazon, which counsel
17 referred to that I think has no revenue. And I
18 think if I remember correctly, has paid under the
19 21 percent prong of this, of this structure.

20 JUDGE STRICKLER: Thank you.

21 JUDGE FEDER: Excuse me. Are you saying
22 that the 21 percent hasn't come into play with
23 Google because the 10 and a half percent of revenue
24 is higher than that or because the 80 cent per
25 subscriber is higher than that?

1 THE WITNESS: I think sort of both. So I
2 think, generally speaking, Google has paid 10 and a
3 half percent of revenue, that that's the higher of
4 that or the minimum. But when you look at the
5 minimum, it has typically been the 80 cents per
6 subscriber that has been the one that would be the
7 relevant number.

8 JUDGE FEDER: Thank you.

9 BY MR. JANOWITZ:

10 Q. Dr. Leonard, the -- whether or not the
11 TCC is triggered is based on a relationship between
12 the TCC in the part B calculation and the revenue in
13 the part A calculation, correct?

14 A. Whether it is triggered or not -- well,
15 and also the 80 cents, though.

16 Q. I understand that. But we look at that
17 as a cap. So let's -- the cap doesn't come into
18 effect, really, unless the TCC is triggered, right?

19 A. I guess I don't view it that way. I view
20 it as -- I look at the TCC. I look at the 80 cents.
21 Whichever one is lower, then that's what gets
22 compared to the 10 and a half percent.

23 Q. I understand that. But my question is if
24 -- if revenues are decreasing, if you have services,
25 for example, at low rates, some sort of a discounted

1 rate, a 5 dollar a month instead of a 10 dollar or a
2 3 dollar, whatever, isn't it possible that you could
3 trigger the 21 percent?

4 A. I mean, is it possible? You know, there
5 is obviously some regions of the space in which it
6 can get triggered certainly, but, again, as an
7 economic reality -- and, again, I can't speak to
8 every Service -- but as far as Google goes, I don't
9 believe it has actually been relevant.

10 Q. Right. But as you say, you can't speak
11 to every Service, with the exception of Amazon, that
12 you mentioned. Can you speak to any other Service?

13 A. I don't -- yeah, I don't think I have had
14 the data to do those calculations.

15 Q. Okay. And according to your report, this
16 is paragraph 78, page 50, at 13 and a half percent
17 of sound recording fees, as Google has proposed, it
18 is likely that the percentage of sound recording
19 royalties prong will be lower than the all-in per
20 subscriber prong, correct?

21 A. Could you point me to that again? I was
22 a little bit behind you.

23 Q. I think it is paragraph 78, page 50.

24 A. Okay. Yep, I'm there, let's see.

25 Q. Okay.

1 A. I'm sorry, what part were you reading?

2 Q. I will read it again.

3 JUDGE STRICKLER: There are some bullet
4 points. Is it above or below the bullet point?

5 MR. JANOWITZ: Let's see.

6 JUDGE STRICKLER: Near the bullet?

7 BY MR. JANOWITZ:

8 Q. I'm sorry, paragraph 78, page 50. I
9 think it is at the top of the page.

10 A. Of -- of 50?

11 Q. It is the last bit on paragraph -- I
12 actually think it is paragraph 80.

13 A. 80, okay. And the last bit, you say?

14 Q. Yeah. The last sentence. Let me know if
15 you see it, is the sentence begins with "that said"?

16 A. Yes.

17 Q. So let me read it again. "That said, to
18 the extent that all-in per-subscriber minima are
19 part of a lesser-of comparison with 13 and a
20 half percent of sound recording fees, as Google has
21 proposed, it is likely that the percentage of sound
22 recording royalties prong will be lower than the
23 all-in per-subscriber prong."

24 So I think what you are saying is that
25 much like what you say was the case with Google when

1 the TCC was 21 percent, when it is 13 and a
2 half percent, it is also not likely to be triggered?

3 A. Let's see. Well, I think I am saying, in
4 fact, at the lower level it may become the more
5 operative minimum. And then it might be triggered
6 if the 10.5 percent of revenue ends up being less
7 than that.

8 MR. JANOWITZ: Could you read that back,
9 please, because I didn't hear it.

10 THE REPORTER: "Answer: Let's see.
11 Well, I think I am saying, in fact, at the lower
12 level it may become the more operative minimum. And
13 then it might be triggered if the 10.5 percent of
14 revenue ends up being less than that."

15 THE WITNESS: I am discussing this in the
16 context of saying, you know, the 80 cent minimum, to
17 the extent it is the operable one, you know, it is
18 possible that there could be plans that a provider
19 might want to offer.

20 You know, again, for lower
21 willingness-to-pay consumers, for instance, it might
22 have 10.5 percent of revenue, less than the 80
23 cents. The 80 cent would become binding. And that
24 could deter somebody from offering the plan.

25 And then this last sentence that you

1 referred to is just saying but, you know, something
2 else to consider is that if we're talking about
3 lowering the TCC part of it to 13.5 percent, then
4 maybe that's not true any more, that maybe the 80
5 cent per subscriber isn't the binding minimum any
6 more, but, instead, would be the 13.5 percent of
7 TCC.

8 BY MR. JANOWITZ:

9 Q. Because it is less?

10 A. It is less.

11 Q. Because it is a lesser-of?

12 A. Correct.

13 Q. And so it becomes the more likely binding
14 prong because you have now reduced it relative to
15 the past from 21 percent to 13 and a half percent,
16 correct?

17 A. That's correct.

18 Q. So it is more likely to become binding,
19 but it is also likely, as compared to the 21 percent
20 -- it is not even likely -- but it will be a smaller
21 minimum, correct?

22 A. Yes. Those two things go hand in hand.
23 It is now sort of too high to really bind
24 meaningfully. If it comes down, it is more likely
25 to bind, but it is lower, yes.

1 Q. So do you see this as a -- this proposal
2 as a benefit to the Copyright Owner as compared to
3 the 21 percent or the 17.36 percent?

4 A. You know, I think it's -- that's a
5 complicated question because let's say in the
6 example I gave, somebody goes out and offers a plan,
7 this aspect of it means the plan is feasible because
8 they are willing to do it at 13.5 percent of service
9 revenue but they wouldn't be willing to do it at 80
10 cents per subscriber.

11 Then they go ahead and do the plan, it
12 generate some revenue, and Copyright Owners earn
13 some royalties on that, that, you know, could very
14 well be beneficial.

15 Q. Do you know whether the 80 cents per
16 subscriber has ever been triggered?

17 A. Yes, I believe Google has on occasion --
18 I don't know if it is all that frequently -- but on
19 occasion has paid the 80 cent subscriber minimum.

20 Q. So that would mean that in that
21 situation, the calculation of the 21 percent TCC
22 would be higher than 80 cents, right?

23 A. If the 80 cents was the binding one they
24 paid, then that means the 21 percent was higher.

25 Q. So in this situation with Google, for

1 example, if you reduce the 13 and a half -- if you
2 reduce the TCC to 13 and a half percent, and 13 and
3 a half percent was binding, then all things, other
4 things being equal, the Copyright Owner would
5 receive less in that calculation?

6 A. Again --

7 Q. Correct?

8 A. -- I think that's just holding the whole
9 rest of the world constant.

10 Q. Yes, it is.

11 A. The reason that the 80 cents ended up
12 binding, as I understand it, is that that had to do
13 with family plan subscriptions. And Google has paid
14 out royalties at 80 cents per, in that case, family
15 member.

16 But, of course, the whole point of that
17 plan is to try to generate more subscribers, and it
18 generates more revenue.

19 So, you know, if you changed, again, the
20 13 or the 21 percent to 13.5 percent and that means
21 that would be a little less, maybe there would be
22 other plans that are able to be implemented that
23 generate more royalties for music owners.

24 Q. Sure. But that would require us to look
25 at other plans. I am trying to look at this --

1 A. Right.

2 Q. -- just in the terms of the calculation
3 in the hypothetical.

4 A. Right. But I am explaining the reason
5 Google hit the 80 cent minimum in those cases was
6 precisely because they did offer a different type of
7 plan.

8 Q. And if they offered it in this situation,
9 and the Google proposal were adopted, then the 80
10 cents would not come into play, it would be the 13
11 and a half in all likelihood?

12 A. We would have to ultimately do the math
13 to know what the sound recording payments were, but
14 that is certainly possible.

15 Q. Dr. Leonard --

16 JUDGE BARNETT: For the 10 and a half, if
17 that's the greater of?

18 THE WITNESS: Yeah, yeah, right. We're
19 only talking about somehow we end up above 10 and a
20 half because otherwise, yeah, that continues to
21 apply, regardless.

22 I should point out I don't think Google
23 has hit the 80 cent minimum very often, but it has
24 happened, so it has typically been at 10 and a
25 half percent.

1 BY MR. JANOWITZ:

2 Q. Dr. Leonard, you are aware, are you not,
3 that entrants into the interactive streaming field
4 often sell complementary goods and services?

5 A. It depends on who you are. Spotify, you
6 know, is pretty much a standalone. Somebody like
7 Google is certainly, when they introduce a music
8 service, they are trying to take their existing base
9 of users and sell them something more; namely,
10 music. And that can be something they can do
11 efficiently because they have an installed base.

12 Q. So Google could do that?

13 A. Well, I think certainly that would be
14 part of the idea is that, look, we have got this
15 installed base, let's see what else we can sell to
16 them.

17 Q. Okay.

18 A. And music is an example of that. And it
19 is one of many examples that Google might try.

20 Q. And do you know of any other service that
21 works this way, that has this attitude towards
22 selling complementary goods and services?

23 A. Well, I mean, anybody who has got a
24 platform, again, you might try to add things to the
25 platform because the platform can drive the sales of

1 those other things, such as music.

2 And Apple, you know, would be another
3 example of that.

4 Q. And you could drive -- when you say the
5 platform could drive the sales of music, music could
6 also drive the sales of other things, correct? It
7 goes both ways?

8 A. So here we really need to distinguish
9 between potential, you know, possibilities and
10 reality. The reality is it doesn't drive sales of
11 anything else Google does, music does not.

12 Q. I understand. But I am talking about for
13 other Services.

14 A. Again, I haven't analyzed other Services.
15 As a general matter, if you sell two things, it is
16 possible one could drive the other. The other could
17 drive the one. They could both drive each other.
18 As just general possibilities, of course any of
19 those are possible.

20 Q. And this is certainly a possibility in
21 this area, correct?

22 A. Again, as a general matter, but you have
23 got to remember, again, what is motivating the Apple
24 and the Googles of the world to do this, is they
25 already have a very successful platform. The

1 question is how can we figure out other things to
2 sell that we can leverage our existing platform.
3 That's really the motivation.

4 It is not going the other way, that we
5 have music and, gee, now we're going to come up with
6 an Android operating system and that's going to be
7 able to exist and survive only because we have
8 music. It is just clearly the reverse.

9 Q. Well, let's take Google out of this
10 discussion for the moment.

11 A. Okay.

12 Q. And look at some of the others. In the
13 case of Amazon, you understand how they work?

14 A. With regard to music or generally?

15 Q. Yeah.

16 A. I have a sense of it, but I haven't
17 studied Amazon to the extent I have studied Google.

18 Q. So Amazon Prime, for example, which is a
19 service that Amazon offers with its Prime membership
20 is not something -- does not require the Amazon
21 customer to pay for the music service, correct?

22 A. Well, or the payment for Prime includes a
23 bunch of different things and you'd have to
24 apportion that out, I think is the right way to
25 think about it.

1 Q. I agree. So that if you were going to
2 have a revenue-based calculation and it was going to
3 be meaningful, you would have to apportion out the
4 revenue attributable to music from the revenue
5 generally received, you know, from Prime
6 subscriptions; is that correct?

7 A. I guess I would disagree with that to
8 some extent. That's why we have or why there are --
9 one reason why there are the minima to take care of
10 that situation amongst others.

11 Q. Yes. But I am not asking you about the
12 remedy for the problem. I am asking you for the
13 problem at this point.

14 In terms of identifying revenue, which is
15 after all the first prong and the first analysis
16 that you have to do, if you had a service where
17 revenue was not recognized or not fully recognized
18 from the music service, and instead was part of
19 another service that the provider had, you would
20 have to do some kind of apportionment, assuming that
21 you were going to try to pay a royalty on a revenue
22 basis, correct?

23 A. You kind of said if you were going to pay
24 a royalty on a royalty basis, then --

25 Q. Royalty on a revenue basis.

1 A. That's right, sorry, a revenue basis,
2 then you would have to have a revenue figure. You
3 know, at some level that's a tautology. The other
4 thing you can do is figure out a different way to do
5 the royalties, such as a per-subscriber or some
6 other way.

7 Q. Or per-stream, you could do it that way,
8 couldn't you?

9 A. I think, again, I haven't studied Amazon
10 completely, but, look, Amazon has a lot of different
11 ways that they could make Prime attractive. This is
12 one that they have chosen to do, but there are a
13 million other ways that they could do.

14 And I think if you made it very expensive
15 for them in that sense they might not do it, and I
16 think that would be a bad thing for Prime
17 subscribers who actually use that service.

18 You know, a perfectly other good way to
19 do it is to do it per-subscriber, to do it as a
20 percentage of sound recording payments, which I
21 think is how they were doing it.

22 Q. But you could do it on a per-stream
23 basis, couldn't you?

24 A. Again, in the sense that anything is
25 possible, yes. I would not recommend that.

1 Q. I understand. And, in addition to
2 Amazon, there are other companies where the music
3 services are bundled with other kinds of goods or
4 services, correct?

5 A. Yes, I think generally that can happen.

6 Q. And it does happen, does it not?

7 A. I think, again, it has happened, yes.

8 Q. And that creates measurement problems and
9 issues in terms of revenue, does it not?

10 A. Again, it does. And that's why
11 Phonorecords II was set up the way it is with the
12 different categories and the minima. And there is a
13 non-portable -- I can't even remember all the
14 configurations, but there is different categories
15 and there are different minima that go with that to
16 address this sort of problem. I think that's a very
17 good way to go about it.

18 Q. Are you aware of Spotify's plans to
19 engage in bundling of its service with other kinds
20 of goods or services?

21 A. I don't think I have studied that, no.

22 Q. Are you aware of it at all?

23 A. That doesn't right now sound familiar to
24 me.

25 Q. Well, there was, there was testimony, and

1 there have been documents introduced in this case to
2 show that Spotify is considering going the bundling
3 strategic route. So if --

4 MR. MANCINI: Objection, Your Honor. I
5 believe that lacks foundation.

6 MR. JANOWITZ: I think not. I think
7 there are Spotify documents in evidence on that.

8 JUDGE STRICKLER: I remember documents
9 along those lines, specifically a document relating
10 to the bundling of Spotify with New York Times
11 subscriptions, but I don't recall whether they were
12 put into evidence or whether they were just used on
13 cross-examination for a witness.

14 MR. JANOWITZ: You know, it is possible
15 that that's how they were used. So let me do it
16 hypothetically and that way we can avoid the
17 problem.

18 JUDGE BARNETT: Okay.

19 BY MR. JANOWITZ:

20 Q. If, hypothetically, Spotify was going to
21 change its business model from a more pure-play,
22 which it currently is, to a service that was
23 bundling with other goods and services which were of
24 higher margin, would that affect your opinion as to
25 the suitability of the revenue modeling for

1 royalties?

2 A. I don't think so because Google's
3 proposal, again, has the various categories. Again,
4 it is a little daunting to figure out sometimes
5 which one of these would -- where something would
6 fit, but I believe there are, you know, bundles and
7 other such things that are already covered. And
8 they are addressed through minima and other things,
9 these issues.

10 So, you know, we can talk about what, you
11 know, the minima should be and things like that. I
12 think Google has proposed basically leaving those as
13 they are. But, you know, that exists precisely to
14 address this kind of issue.

15 JUDGE STRICKLER: If I may interject for
16 a second, Dr. Leonard, I want to ask you a question
17 about bundling in your role as an expert as an
18 economist.

19 THE WITNESS: Sure.

20 JUDGE STRICKLER: On economic theory. Is
21 bundling utilized to, to engage -- by a seller to
22 engage in price discrimination?

23 THE WITNESS: It can be. That's one of
24 the possible motivations for bundling.

25 JUDGE STRICKLER: Is it a primary

1 motivation or does it simply depend on the
2 circumstance?

3 THE WITNESS: You know, there is a lot of
4 different economic models. Some address market
5 power monopolization reasons. Some address price
6 discrimination. Some address other reasons.

7 You know, bundling is very, very common.
8 And I think in one form or another, its attempts
9 even by pretty competitively positioned firms to
10 price discriminate, and I mean by that, of course,
11 for anyone that is not an economist, I don't mean
12 that pejoratively, but it is a way to sort out
13 customers into willingness-to-pay groups.

14 JUDGE STRICKLER: You anticipated my
15 question. It is trying to sort customers according
16 to willingness to pay, which is the same goal as
17 using percentage-of-revenue pricing, you move down
18 the demand curve to exploit the willingness to pay
19 of customers who have a lower willingness to pay,
20 right?

21 THE WITNESS: Yeah, exactly, yeah. And I
22 think, you know, again, from the point of view of
23 the musical work Copyright Owners, you know, that is
24 a good thing. I mean, trying to, again, get as many
25 people in the door, perhaps at different price

1 points and generating a lot of revenue is a good
2 thing.

3 JUDGE STRICKLER: But now let's take it
4 again back to bundling, which is the point of the
5 cross-examination at the moment.

6 THE WITNESS: Yes.

7 JUDGE STRICKLER: When you bundled, your
8 last example on the table, with Spotify and what I
9 recall New York Times subscriptions being bundled
10 together, so if somebody were to pay money, which
11 constitutes revenue, maybe a royalty base, maybe
12 not, that's the open question, and they are paying a
13 certain amount for the bundle, you are teasing out
14 willingness to pay for the bundle, which by
15 definition is different than the sum of the
16 individual willingness to pay for the individual
17 items or else you wouldn't bother to bundle at all.

18 THE WITNESS: Correct.

19 JUDGE STRICKLER: So isn't it necessary
20 in some way to tease out what revenue is
21 attributable in the bundle to the Spotify music
22 service and what portion of the bundle is
23 attributable to The New York Times subscription in
24 order to figure out how much of the revenue in that
25 bundle needs to go into the royalty base and pay the

1 Copyright Owner?

2 THE WITNESS: So I would say conceptually
3 that that is correct, that is certainly one way to
4 going and figure out what the right royalty should
5 be. I would say, you know, as we know, that can be
6 difficult in a given situation.

7 So I guess what I would say in this -- as
8 we're sitting here is we do have these different
9 categories. We have the different minima. At this
10 point I would say that a fruitful approach is to
11 say, look, are the minima working? Are people
12 introducing these kind of plans? And then try to
13 see, you know, perhaps analyze the minima and see
14 whether they seem to be out of whack in one way or
15 another.

16 And, you know, as to the first question,
17 it seems like, you know, this is maybe an example, I
18 don't know if Spotify is actually doing it, but,
19 hey, that might be a great idea for them to do that.
20 And if they are doing it, it would suggest that
21 whatever grouping it would fall into, that the
22 minima there aren't too high, which is good, but,
23 you know, somebody could argue, well, the minima are
24 too low. Again, that's something I think somebody
25 could analyze, taking an approach similar to what

1 you are talking about, but I guess I just don't see
2 any evidence right now that they are way out of
3 whack one way or the other.

4 JUDGE STRICKLER: Is it your
5 understanding, and this goes to a question Judge
6 Feder asked this morning, that the categories within
7 Subpart B and Subpart C for that matter, but let's
8 take Subpart B, as they are defined, are sufficient
9 to cover the bundles that we find in the marketplace
10 as we sit here today?

11 THE WITNESS: I think that's a very good
12 question too.

13 JUDGE STRICKLER: It was his question.

14 THE WITNESS: Yeah, it seems like that --
15 I mean, there certainly were a number of them. And
16 my understanding is that in Phonorecords, whatever
17 it was, II, that a lot of those were added at that
18 point because I think by then there was a sense that
19 these other things were coming down the pike.

20 And I think they did foresee a lot of
21 what, you know, we might -- are seeing now, that
22 they would fit into those buckets. But I wouldn't
23 say that I have kind of gone through every existing
24 plan and said does it have a bucket that fits, it
25 fits neatly into? And I would certainly, if

1 somebody had the suggestion about a different sort
2 of bucket that should be created, I certainly think
3 that's a good idea.

4 JUDGE STRICKLER: So if I understand you
5 correctly then, you haven't held up -- tried to
6 match up, use one as a template against the other
7 and say this category, these categories that are in
8 Subpart B cover 100 percent of all the things that
9 exist in the market, now you don't know the answer
10 to that question because you haven't studied it?

11 THE WITNESS: Yeah, I don't know
12 100 percent. And for Google, I think that its
13 offerings fit in perfectly fine. It seems like the
14 other ones that I'm aware of have a corresponding
15 category, but I can't say I have looked at every
16 plan.

17 JUDGE STRICKLER: Is there anything in
18 your testimony or any of the other evidence from
19 Google that you are aware of that does make that
20 sort of template alignment, as it relates to Google,
21 saying here are Google's floor offerings, by the
22 way, hypothetically, and here are each of the
23 categories, this one will go into portable
24 subscriptions, and this one will go here and this
25 one will go there.

1 Is there anything in the evidence that
2 tells us where they would go?

3 THE WITNESS: I think my report does say
4 here is what Google offers and here is what
5 categories they would fall in.

6 JUDGE STRICKLER: Thank you.

7 BY MR. JANOWITZ:

8 Q. Dr. Leonard, you said that, you know, it
9 is possible that you could observe that the minima
10 are out of whack, correct?

11 A. It is possible, yes.

12 Q. And it is possible that they might be too
13 high and they might be too low, correct?

14 A. Again, if they are out of whack, it could
15 be in either direction.

16 Q. Okay. So what has been done in terms of
17 analysis of data to determine whether the
18 13.5 percent is neither too high nor too low?

19 A. 13.5? Well, that one is a Subpart A
20 analysis, I believe, supports the 13.5 percent.

21 Q. If the -- if the Services do not report
22 revenue and yet there is a great deal of revenue
23 made, which might otherwise be attributable to the
24 music if you could divide it up, is the 13.5 percent
25 a good proxy for the revenue that would otherwise

1 have been calculated and paid on?

2 A. I sort of think we're -- do you mean 13.5
3 or do you mean something else?

4 Q. No, I mean the 13.5 percent. Because
5 we're positing a situation where the revenue is
6 either nonexistent or too low.

7 A. Right.

8 Q. So that the 13.5 percent is triggered.

9 A. So the purpose of that one is to say more
10 or less, is to piggyback if it were off of the
11 label, so in a situation where the labels have
12 approached a company and said, okay, here is what
13 the sound recording royalty, or they negotiate and
14 come up with the sound recording royalties, and
15 we're saying, okay, then when we get to the musical
16 work, it should get 13 and a half percent of that,
17 so I think that is another way around this issue of
18 not having to actually dig into the revenue in this
19 proceeding. This provides some protection that
20 piggybacks off the labels.

21 Q. But that, that piggybacking off the
22 labels has no relationship to the amount of the
23 revenues that a Service may have earned and not
24 reported, correct?

25 JUDGE STRICKLER: Because your question

1 presumes that we're in the part where it is the
2 10.5 percent prong that is applicable?

3 MR. JANOWITZ: It would be, assuming it
4 would be if we knew what the revenues were. And
5 since we don't, the 13 and a half percent is
6 applied, and that's based upon the sound recording
7 payments. And it seems to me that those payments
8 are not linked in any way to revenue being earned by
9 the Service.

10 JUDGE STRICKLER: Thank you.

11 THE WITNESS: I guess I would disagree
12 with that because, again, what are the labels doing?
13 Presumably they have in their negotiation, they have
14 reached their number based on various factors,
15 perhaps, including the revenue.

16 BY MR. JANOWITZ:

17 Q. But the labels -- let's take the case of
18 Spotify. Spotify is owned in significant part in
19 excess of -- I think this may be restricted. The
20 number is restricted.

21 JUDGE BARNETT: Is it or isn't it?

22 MR. JANOWITZ: It is.

23 JUDGE BARNETT: Okay. Are you going to
24 have a section of restricted inquiry?

25 MR. JANOWITZ: I wasn't planning on it.

1 Maybe I can walk around it.

2 JUDGE STRICKLER: Were you going to
3 mention percentage of revenue Spotify pays to the
4 labels?

5 MR. JANOWITZ: No, I was going to talk
6 about the equity. But the equity -- I believe the
7 equity is not the percentage, right? Is that it?

8 JUDGE STRICKLER: Maybe you can make up a
9 hypothetical percentage and don't use the real one.

10 MR. JANOWITZ: Okay. I don't think -- I
11 am not sure I know the real one, so --

12 JUDGE BARNETT: So are we open?

13 MR. JANOWITZ: We're open.

14 JUDGE STRICKLER: Maybe you better find
15 out what the real one is to make sure you don't use
16 it.

17 MR. JANOWITZ: All right. I think I am
18 going to try to be safe on this.

19 BY MR. JANOWITZ:

20 Q. Let's assume hypothetically that the
21 labels own 14 percent of Spotify.

22 A. Okay.

23 Q. And Spotify, you know, has been valued at
24 8 billion dollars or more, correct?

25 A. There are numbers floating around. That

1 sounds around right.

2 Q. Right. So let's say the labels have
3 14 percent of Spotify. Does it appear to you that
4 you might not be able to fully rely on the integrity
5 of the sound recording payments when the labels have
6 another agenda and another way of making money that
7 could be perhaps, you know, a lot better than
8 getting sound recording royalties?

9 And would that not create a problem for a
10 Copyright Owner whose royalties were linked to the
11 sound -- to the TCC?

12 A. Well, I mean, clearly this would only
13 apply within the context of Spotify.

14 Q. Or any other company that was also owned
15 by labels?

16 A. Okay. Yeah, this isn't owned. This is,
17 in your number of 14 percent, you know, that's not
18 anywhere near a controlling interest, obviously.
19 And, you know, part of what that means is if what
20 you are saying is would they give a special deal to
21 Spotify?

22 You know, first of all, we have got the
23 other minima and the 10.5 percent, but even putting
24 all that aside, you know, you have got to think
25 about why would the labels do this? Well, if they

1 thought they were going to get a bigger share, I
2 guess, for Spotify somehow, but the problem is when
3 you only own 14 percent, then you only at best,
4 assuming you even get a dividend in the end, get
5 14 percent of that, and the rest is accruing to all
6 the other owners.

7 So it is -- it's -- I don't know -- a
8 very questionable strategy that I find it hard to
9 believe that it would make any sense here, plus I
10 don't think there is any evidence of it.

11 Q. So if you owned 14 percent of a company
12 with an 8 billion dollar valuation, you think that
13 you could only get dividends for that?

14 A. Well, ultimately, of course, the
15 company's value is equal to present discounted value
16 of its dividends. That's basic finance.

17 Q. Are you aware that in the case of Spotify
18 that there is great likelihood that there will be an
19 initial public offering?

20 A. Okay, but if you -- if you are a buyer
21 who is going to buy into this IPO and you are
22 rational, are you going to pay money on a certain
23 set of financials when you know that the minute you
24 sell your shares, the labels are going to come back
25 and say well, sorry, the royalties are a lot higher.

1 I mean, it just can't work, unless there is some
2 deception going on.

3 And then I think we're going to be seeing
4 SEC investigations. And I am sure that's not going
5 to be happening, so I don't -- this is just not a
6 plausible scenario.

7 Q. By the way, I couldn't resist. You say
8 14 percent of a company is not -- is not control?

9 A. 14 percent by itself is not a controlling
10 interest, no.

11 Q. In a public company?

12 A. Well, if what you mean is can I sort of
13 decide what's going to happen, the answer to that is
14 no.

15 JUDGE STRICKLER: That was a hypothetical
16 number, wasn't it?

17 MR. JANOWITZ: It was.

18 BY MR. JANOWITZ:

19 Q. Let's talk a little bit about the
20 elimination of the 50 cent per-subscriber per-month
21 mechanical-only floor. The Google proposal
22 eliminates that floor, correct?

23 A. Correct.

24 Q. And in this currently construction 115
25 recognizes the possibility that the calculation of

1 the all-in royalty pool, even using the TCC, might
2 result in a royalty that is less than 50 cents per
3 subscriber per month after the deduction of
4 performance royalties, correct?

5 A. My understanding is the floor is there,
6 and the reason it might be there is if -- or the
7 consequence of it being there is if the other
8 calculations below 50 cents and the floor would then
9 guide what the royalty would be.

10 Q. Right. And Google's proposal continues
11 the deduction of performance royalties but
12 eliminates the mechanical-only floor, correct?

13 A. That's correct.

14 Q. So this added protection, this level of
15 protection which could come into effect if it is
16 greater than the TCC calculation, right, would be
17 eliminated under Google's proposal, correct?

18 A. Well, the minimum would get eliminated.

19 Q. Sorry?

20 A. Sorry, the mechanical-only floor would be
21 eliminated under Google's proposal.

22 Q. Right. And by definition, the
23 mechanical-only floor would only have been triggered
24 if it was greater than, assuming you are using the
25 TCC, it would be greater than the TCC?

1 A. You mean if everything else is dropped
2 out, now we're just looking at the TCC? Well, yeah,
3 by definition, I think, if you have eliminated
4 everything else, only TCC and the 50 cents are left,
5 the 50 cents will apply, if the TCC is less than
6 that.

7 Q. And isn't it true that with a reduction
8 of the TCC proposed by Google, the mechanical-only
9 floor, if continued, would be more likely, rather
10 than less likely to be triggered?

11 A. Again, probably in general, if you are
12 going to reduce the TCC, then there is more
13 likelihood that it will hit. If it hits then -- it
14 does slow down. I would certainly agree with that.

15 Now, the actual change in likelihood,
16 again for Google, would be fairly minimal in either
17 direction.

18 Q. Can you speak to the other Services on
19 this point?

20 A. I haven't gone back to see how often it
21 is currently, if at all, triggered by any other --
22 in any other Service.

23 Q. So inasmuch as the Google proposal
24 continues the deduction of the performance royalties
25 but eliminates the mechanical-only floor, isn't it

1 true that an increase in performance royalties
2 licensed by the PROs could eat into the mechanical
3 royalty and possibly eliminate it?

4 A. That is possible. And, again, that's
5 actually the exact reason to get rid of the
6 mechanical-only minima.

7 Q. From the perspective of the interactive
8 streamers?

9 A. I would say from the perspective of the
10 801(b)(1) factors.

11 Q. But you can understand that the Copyright
12 Owners might not see this as an advantage, correct?

13 A. Well, I mean, it is interesting. Again,
14 are we talking about songwriters or are we talking
15 about publishers? I think there is an important
16 distinction there.

17 And, again, you know, recognizing all the
18 issues about royalty stacking and everything else,
19 it is not entirely clear that a bigger royalty stack
20 is actually ultimately good for even the
21 songwriters.

22 Q. Let's turn to your --

23 JUDGE STRICKLER: You say it is not good
24 for the songwriters, but would it be good for the
25 publishers?

1 THE WITNESS: You know, again, in
2 principle, that could be a different subject. You
3 know, my view --

4 JUDGE STRICKLER: They represent both
5 here, right?

6 THE WITNESS: There is, I think there is
7 some interesting tension there, but yeah.

8 JUDGE STRICKLER: You are assuming
9 existence or lack of tension, but the royalties
10 we're talking about flow into the publishers and
11 through to the songwriters to some extent, right?

12 THE WITNESS: That's my understanding,
13 yes.

14 JUDGE STRICKLER: So my question still
15 stands. Doesn't having a mechanical floor benefit
16 the publishers, separate and apart from any analysis
17 you might do of the songwriters?

18 THE WITNESS: Yeah, I mean, there are
19 also payments, I think, through the PROs to
20 publishers, but -- so, again, we have to evaluate
21 the whole thing and take into account the effects of
22 royalty stacking and everything else.

23 So I think it is -- it is hard for me to
24 say here, but I would say, what I think I can say is
25 the elimination of the floor is more likely to have,

1 you know, so-called, you know, reduction in revenue
2 for the publishers than it would be for the
3 songwriters.

4 JUDGE STRICKLER: Thank you.

5 BY MR. JANOWITZ:

6 Q. Turning now to your -- to the existing
7 agreements as benchmarks, when I questioned you
8 earlier on the use of the Subpart A settlement as a
9 benchmark, we talked about the existence of the
10 shadow and the compulsory, correct, do you recall
11 that?

12 A. I recall that, yes.

13 Q. You would agree that the same shadow
14 falls over the benchmark agreements that are
15 addressed in your report; is that correct?
16 Forgetting about what you think the impact is,
17 whether it is good or whether it is bad, but it
18 exists?

19 JUDGE STRICKLER: Counsel, in your
20 question are you able to distinguish between what
21 you are calling the shadow as between the shadow of
22 the license and the rates as they exist?

23 MR. JANOWITZ: Yes.

24 JUDGE STRICKLER: And the shadow of a
25 proceeding that would go forward in the event you

1 don't come to agreement?

2 THE WITNESS: I was going to make, for
3 what it is worth, I was going to make that
4 distinction myself.

5 MR. JANOWITZ: Your Honor, I think it is
6 hard to make that distinction because when -- these
7 are recent agreements. I think they are -- take
8 effect in 2016.

9 Whenever they would have been negotiated,
10 to the extent that there is a compulsory license,
11 then that compulsory license would have, I think,
12 affected in some way those agreements.

13 JUDGE STRICKLER: Doesn't it depend on
14 the term of the license, if you are talking about a
15 license that has an effective term during a rate
16 period, then it is the shadow of the rate that
17 exists. If you were to enter into a contract today
18 for mechanical royalties, that was going to be in
19 the year 2021, you would be worried about we're
20 doing here today. It would be somewhat a different
21 shadow.

22 MR. JANOWITZ: It is somewhat different
23 but it is a little hard to pry apart, for me, at
24 least, because I think the context of this
25 proceeding is that there will be some compulsory,

1 you know, license.

2 And obviously we don't know what that's
3 going to be, but it has that effect. And given the
4 factors, you know, I think you probably, if you were
5 a publisher or a copyright owner, probably feel the
6 impact of both the existing statute and the fact
7 that there is going to be a proceeding which will in
8 some way change that -- that license, but maintain a
9 compulsory nonetheless.

10 JUDGE BARNETT: Are you testifying, Mr.
11 Janowitz?

12 MR. JANOWITZ: No, I was simply answering
13 -- I was really trying very hard to answer.

14 JUDGE STRICKLER: I want to be able
15 understand the question. So I appreciate the
16 answer, since the witness indicated that he had the
17 same sort of question, I wanted to make sure that
18 whatever colloquy ensued --

19 MR. JANOWITZ: Absolutely.

20 JUDGE STRICKLER: -- we were all using
21 commonly agreed-upon terms.

22 MR. JANOWITZ: I understand. And I
23 appreciate your giving me the opportunity to explain
24 it.

25 BY MR. JANOWITZ:

1 Q. So with that, can you answer the
2 question?

3 A. I don't even know if I know what the
4 question is.

5 Q. I will rephrase it. Is the -- in the
6 benchmark agreements that you are relying on in your
7 report, do you feel -- is it your opinion that there
8 is a shadow of a compulsory that affects those
9 agreements, whether you consider it as the shadow of
10 the existing compulsory or the shadow of the, you
11 know, the proceeding that is upcoming and has
12 arrived?

13 A. Yeah, I would draw the distinction,
14 because one thing you said, I think I disagree with,
15 is most of the agreements I looked at, at least the
16 ones that I am remembering as I am sitting here,
17 generally would have been, the term would have
18 expired prior --

19 MR. ELKIN: Objection, Your Honor. Some
20 of the -- the agreements at least with respect to
21 Amazon are restricted. I don't know the extent to
22 which the answer is going to encroach on to the
23 specific terms, but they started to go into that
24 direction.

25 MR. JANOWITZ: And we are -- we're going

1 to be heading into some restricted material.

2 JUDGE BARNETT: Why don't we go ahead and
3 ask anyone in the courtroom who is not privy to
4 restricted or confidential information to wait
5 outside, please.

6 MR. ELKIN: Thank you.

7 (Whereupon, the trial proceeded in
8 confidential session.)

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1 O P E N S E S S I O N

2 REDIRECT EXAMINATION

3 BY MR. WETZEL:

4 Q. Good afternoon, Dr. Leonard.

5 A. Good afternoon.

6 Q. You were asked some questions earlier on
7 your reliance on the Phonorecords II settlement and
8 where it appears in your amended expert testimony.

9 Do you recall those questions?

10 A. Yes, I do.

11 Q. If I could turn your attention for a
12 moment to page 7, paragraph 13 of your statement,
13 Exhibit 695. If you could take a look at the second
14 circular bullet there, let me know when you are
15 finished.

16 A. Let's see. Yes, I see it.

17 Q. Does that refresh your recollection about
18 how you relied on the Phonorecords II settlement as
19 part of your benchmark analysis?

20 A. Yes.

21 Q. And just so we're clear, how was that?

22 A. It was part -- it was one of the things I
23 looked at in support of the overall rate structure
24 that was proposed by Google.

25 Q. You were also asked some questions about

1 the proposed deduction from revenues that Google has
2 made in this proceeding.

3 Do you recall those questions?

4 A. Yes.

5 Q. Now, under Google's proposal, if Google
6 agreed to pay, for example, 10 percent more of its
7 service revenues in credit card fees to take
8 advantage, I believe was the term, of the up to
9 15 percent deduction, how much would Google get back
10 by virtue of that deduction under Google's proposal?

11 A. I guess it would be 10 percent of that.

12 Q. And would that be a rational economic
13 decision, in your opinion?

14 A. I don't think so, no.

15 Q. Would it be efficient for Google to do
16 that?

17 A. No.

18 Q. I would like to mark a document for
19 identification. It is Google Exhibit 1701.

20 (Google Exhibit 1701 was marked for
21 identification.)

22 JUDGE FEDER: This is not in the binder?

23 MR. WETZEL: No, this is a document that
24 we pulled during lunch.

25 JUDGE BARNETT: I want you to go get

1 binders for that.

2 (Laughter)

3 MR. WETZEL: I believe next in order is
4 1701, Exhibit 1701.

5 THE WITNESS: Thank you.

6 BY MR. WETZEL:

7 Q. Dr. Leonard, have you had an opportunity
8 to review Exhibit 1701?

9 A. Yes, I have.

10 Q. What is Google Exhibit 1701?

11 A. It is Google's proposal as to what the
12 115 rate should be.

13 Q. And if I could direct your attention to
14 pages 31 and 32 of Exhibit 1701. Let me know when
15 you have had a chance to review that.

16 A. Yes.

17 JUDGE BARNETT: Did you ask that this be
18 admitted?

19 MR. WETZEL: Yes, ultimately, Your Honor.

20 JUDGE BARNETT: Then we can't get into
21 the contents of it until it is admitted.

22 MR. WETZEL: Fair enough. I move Google
23 Exhibit 1701 into evidence.

24 MR. JANOWITZ: No objection.

25 JUDGE BARNETT: 1701 is admitted.

1 (Google Exhibit Number 1701 was received
2 into evidence.)

3 JUDGE BARNETT: Now, proceed.

4 MR. WETZEL: Thank you.

5 BY MR. WETZEL:

6 Q. Does reviewing pages 31 and 32 refresh
7 your recollection about Google's proposal with
8 respect to the TCC minimum payment and pass-through
9 and non-pass-through circumstances?

10 A. Yeah, I see here that it actually does do
11 the calculation I talked about, and so it does have
12 a number both for the with-pass-through and
13 without-pass-through situation.

14 Q. What is the corresponding TCC rate Google
15 proposes for the pass-through context where the
16 labels are paying the Copyright Owners under the 115
17 license?

18 A. 11.9 percent.

19 Q. And does that, without asking you to do
20 the calculation here, does that appear to be
21 approximately the right ratio relative to the
22 21 percent to 17.36 percent ratio in the existing
23 rates?

24 A. It does seem to be, yes.

25 JUDGE STRICKLER: Which pages are you

1 referencing?

2 MR. WETZEL: 31 and 32.

3 JUDGE STRICKLER: That's Subpart C,
4 correct?

5 JUDGE BARNETT: I surreptitiously did the
6 math and I think it is correct.

7 MR. WETZEL: Thank you.

8 BY MR. WETZEL:

9 Q. I could also direct your attention to
10 page 11, if that's helpful.

11 A. Right. So the same numbers -- well, the
12 same adjustments appear here.

13 Q. And page 11 pertains to Subpart B,
14 correct?

15 A. Yes, it appears to be.

16 MR. WETZEL: I have no further questions.

17 JUDGE STRICKLER: I have one or two.
18 Dr. Leonard, following up on what we discussed
19 briefly this morning, you were going to take a look.

20 THE WITNESS: I did. I took a look.

21 JUDGE STRICKLER: Allow me, before you
22 respond to the old version of the question, let me
23 garble it this afternoon for you.

24 THE WITNESS: Okay, sure.

25 JUDGE STRICKLER: The first question

1 related to what was -- now I am back to your
2 original report, paragraph 14 on your original
3 report, which I am guessing is paragraph 16 in the
4 amended report, the one that begins with the words
5 "music publishers are entities." Can you check out
6 16?

7 THE WITNESS: Yeah.

8 MR. JANOWITZ: It is 15.

9 JUDGE STRICKLER: "Music publishers are
10 entities," do you see that?

11 THE WITNESS: Yes.

12 JUDGE STRICKLER: And I had asked you,
13 you had written after you had listed Sony/ATV,
14 Warner/Chappell, Universal Music Publishing, "these
15 firms hold a significant combined position
16 controlling the majority of the U.S. music
17 publishing market." Do you see that?

18 THE WITNESS: I do.

19 JUDGE STRICKLER: The question I believe
20 I asked you this morning was whether or not you
21 relied on that assertion to draw any of your
22 conclusions elsewhere in the report?

23 THE WITNESS: I would say no. I reviewed
24 my report at lunch, and I couldn't find any other
25 real mention of this topic.

1 JUDGE STRICKLER: Okay. Thank you for
2 that.

3 Also I had asked you with regard to what
4 I see as paragraph 17, so I am guessing it is
5 paragraph 18, the paragraph that begins "a record
6 company (or label) typically finances"?

7 THE WITNESS: Yes.

8 JUDGE STRICKLER: Then you go all the way
9 down towards the bottom of that, exactly six lines
10 up from the bottom and you said, these major record
11 labels share common ownership of the major music
12 publishers discussed above. For example, Sony
13 Corporation owns SME and half of Sony/ATV and then
14 you went on about Universal and Warner/Chappell.

15 Do you see that?

16 THE WITNESS: Yes.

17 JUDGE STRICKLER: Did you rely on that
18 assertion, those assertions of fact in drawing any
19 other conclusions in your analysis in your report?

20 THE WITNESS: Again, I would say not. It
21 doesn't really come up again in this report.

22 JUDGE STRICKLER: One other thing I think
23 you said you were going to check on and you may have
24 already covered in your cross-examination question
25 and answer was with regard to the impact of the

1 alleged impact of a regulatory shadow on your
2 analysis.

3 Have you already covered that in your
4 cross-examination?

5 THE WITNESS: Yeah, I would say I have
6 covered my views on that. They may be expanded a
7 bit in my rebuttal report, but, again, I don't think
8 in this report that that is directly addressed.

9 JUDGE STRICKLER: Thank you.

10 JUDGE FEDER: I have a couple of
11 questions as well.

12 Could I direct your attention back to
13 paragraph 47 on page 30 of your direct testimony.

14 JUDGE STRICKLER: What paragraph is that?

15 JUDGE FEDER: 47.

16 THE WITNESS: Sorry, was that paragraph
17 or page 47?

18 JUDGE FEDER: Page 30, paragraph 47.

19 THE WITNESS: Okay. I am there.

20 JUDGE FEDER: It begins "in general."
21 Well, it says, "In general, in the absence of any
22 constraints, the outcome of an arm's-length
23 negotiation between unrelated parties represents a
24 fair outcome for both parties as contemplated under
25 Section 801(b) (1) (B) ."

1 THE WITNESS: Yes.

2 JUDGE FEDER: Why is it important that
3 they be unrelated parties? What would be the --
4 your concern about a negotiation between related
5 parties in this context?

6 THE WITNESS: I'm not sure I had a
7 concern about this context. I think I was just
8 putting this in here because I think about it more
9 generally that way, but, you know, when they are
10 related parties, there may be certain incentives to
11 structure things in a certain way or provide a given
12 price, so, you know, that's a concern, say, in
13 transfer pricing where one entity is sort of paying
14 another for IP rights, for instance, they may look
15 and say, hey, was whatever rate was agreed to, was
16 this done as if they were unrelated parties? That
17 would be much more useful as a benchmark than if
18 they were doing it as related parties.

19 JUDGE FEDER: So from the standpoint of a
20 benchmarking analysis, like what you have done here,
21 would the -- would having related parties on both
22 sides of an agreement tend to lessen the value of
23 that agreement as a benchmark?

24 THE WITNESS: I think having -- I mean,
25 in general, if there were related parties on both

1 sides of the agreement and, you know, again, as in
2 the transfer pricing case, they weren't, you know,
3 being instructed to act as if they were unrelated,
4 you know, then that potentially could cause a
5 concern.

6 I think I would want to look deeper and
7 see if there was any issues specifically that might
8 arise, but it certainly raises more concerns than if
9 they were just unrelated parties.

10 JUDGE FEDER: Okay. And just shifting
11 topics a little bit --

12 JUDGE STRICKLER: Before we switch topics
13 because I want to follow up on that.

14 JUDGE FEDER: Go ahead.

15 JUDGE STRICKLER: So if I understand your
16 testimony correctly in response to those questions,
17 the fact that they are unrelated parties -- excuse
18 me. The fact that they are related parties could
19 cause you concern, but you would have to investigate
20 further to determine whether or not the fact that
21 they are related has affected the value of any --
22 the benchmark value of any contract entered into?

23 THE WITNESS: Yes, that's right.

24 JUDGE STRICKLER: Thank you.

25 JUDGE FEDER: Judge Strickler earlier on

1 asked a question he attributed to me, and it was a
2 question I had asked but of a different witness, and
3 that goes to the different -- the different buckets
4 in Subparts B and C, where there are, you know,
5 separate rates for various kinds of activities.

6 THE WITNESS: Right.

7 JUDGE FEDER: That were presumably
8 designed around activities that existed or were
9 contemplated in the marketplace in 2012 when that
10 settlement was put in place.

11 My question is does carrying those
12 categories forward in a regulation that will be
13 enforced for another five years run any risk of
14 distorting marketplace of funneling activities into
15 those buckets, rather than innovating and creating
16 new types of services?

17 THE WITNESS: I certainly haven't seen
18 any evidence that anyone, in coming up with a plan
19 or a service or product, that they have been too
20 worried about the exact buckets here. So I don't
21 think that's too much of a concern.

22 And as I mentioned, you know, in a way
23 they address a lot of the -- at some level, a lot of
24 the types of services you might expect to see. Now,
25 that being said, if someone were to come in here and

1 say: Hey, there is this new service that could
2 exist, and we don't think it fits neatly into these,
3 we think there would be a new one, I would be all in
4 favor of that because obviously it helps to
5 appropriately, you know, match things into the right
6 bucket.

7 But I haven't seen any evidence that
8 there is a real big issue there.

9 JUDGE FEDER: Thank you.

10 JUDGE STRICKLER: Following up on those
11 questions and answers, if we did not have the
12 different buckets and it went to just a single rate
13 structure for all various types of services and
14 differentiated products, you believe that would or
15 would not cause disruption in the market?

16 THE WITNESS: I think that would -- well,
17 I mean, it depends what the -- I suppose at some
18 level what the rates and the structures are, but, I
19 mean, if we're talking about a single, you know,
20 percentage of royalty rate, for instance, then -- a
21 percentage of revenue rate without any kind of
22 minimum or something like that --

23 JUDGE STRICKLER: Let me interrupt you.
24 That would mischaracterize. I may not have stated
25 clearly what I meant.

1 THE WITNESS: I'm sorry.

2 JUDGE STRICKLER: We have been using for
3 example the portable subscription service structure.

4 THE WITNESS: Right.

5 JUDGE STRICKLER: With its minima, and
6 the percentage of revenue, and the greater of and
7 the lesser of within the greater.

8 If we only had one of those, we didn't
9 have different buckets for that --

10 THE WITNESS: I see.

11 JUDGE STRICKLER: -- would that be
12 disruptive in the market?

13 THE WITNESS: I think it could be because
14 the 80 cents per subscriber minimum does differ
15 across the bucket. So if you did away with that,
16 then there could be certain buckets suddenly --
17 let's say ones that didn't have revenue or, you
18 know, again we're aimed at low willingness to pay
19 people and maybe had low, relatively low revenue
20 because of that.

21 The percentage of revenue might be low,
22 the 80 cents would kick in, and then the Service
23 would say, if it was categorized in that group, you
24 know, we can't do this; whereas it may fit into one
25 of the existing groups as a lower subscriber minimum

1 and then it could work.

2 And, you know, again, I think that would
3 be good for consumers, actually ultimately good for
4 the Copyright Owners and the Services as well.

5 JUDGE FEDER: To the best of your
6 knowledge, why are there different per-subscriber
7 minimums for the different categories?

8 THE WITNESS: I think it is a recognition
9 of exactly this idea, that the different types of
10 products you would be offering are going to have
11 different values. So, for instance, a limited
12 interactive service, you know, it has certain
13 constraints. People are going to do it, aren't
14 going to pay as much, but that's, you know, again, a
15 way to separate people into -- people are like: All
16 right, I will put up with streaming because I don't
17 want to pay a lot for music service, but I would
18 like to have a little more flexibility versus
19 somebody who is willing to pay more and have full
20 access, unhindered to the library.

21 Again, that's a good outcome. The
22 different, those different buckets, I think, have
23 different minima. And that helps allow the Services
24 to develop those kind of plans.

25 JUDGE FEDER: So when you are saying

1 value, are you talking basically about subscription
2 price, that certain things are offered at different
3 subscription prices?

4 THE WITNESS: Value, yeah, I mean for the
5 price of the plan, but then that reflects a value to
6 the type of consumer that you are targeting with
7 that plan.

8 JUDGE FEDER: So, theoretically, could
9 one construct a rate structure that had a
10 per-subscriber minimum that was -- that moved
11 together with the subscription price?

12 THE WITNESS: Yeah, I think that's
13 possible. And I think in a way that is what is
14 trying to be accomplished here.

15 You know, you could have a million
16 different buckets. And the problem with that, I
17 guess, is that makes life very difficult for you
18 guys and maybe for everybody, but -- so there has
19 got to be some tradeoffs there, but, yeah I think
20 the idea is to try to have buckets with different
21 minima that are reflecting the nature of the plan
22 that would fit into the bucket.

23 JUDGE BARNETT: May this witness be
24 excused?

25 MR. WETZEL: Yes, Your Honor.

1 JUDGE BARNETT: Thank you, Dr. Leonard.

2 THE WITNESS: Thank you.

3 JUDGE BARNETT: It appears we have
4 Alyeshmerni next?

5 MR. STEINTHAL: We have, Your Honors,
6 Elliot Alyeshmerni from Google was one of the
7 witnesses where cross-examination was waived. We
8 are simply moving into evidence Google Exhibit 694,
9 which is the written direct testimony of Elliot
10 Alyeshmerni, and Google Exhibit 551, 552, 553 and
11 560, which are attached and referenced in Mr.
12 Alyeshmerni's direct testimony.

13 JUDGE BARNETT: Thank you.

14 MR. SCIBILIA: And Copyright Owners have
15 an objection to one of those exhibits.

16 JUDGE BARNETT: Which one?

17 MR. SCIBILIA: That is Exhibit 551. And
18 the reason, the basis for the objection is that this
19 is a spreadsheet that purports to show losses
20 incurred over several of Google's services,
21 including download service and other offerings that
22 aren't at issue in this case.

23 But, more importantly, the losses shown
24 are the result of an allocation of global costs,
25 including infrastructure costs and customer support

1 costs. And Google has produced no information to us
2 whatsoever as to how the allocations were made or to
3 which, you know, the total revenues to which those
4 costs relate.

5 So they really presented an incomplete
6 picture here that doesn't show us and gives us no
7 way of getting behind the proprietary of the cost
8 allocations made in the spreadsheet.

9 MR. STEINTHAL: I can easily respond to
10 that, and I think we probably should have any more
11 detailed discussion of this in restricted session,
12 rather than in open session.

13 JUDGE BARNETT: Okay. Could we have a
14 moment to close the courtroom or the hearing room,
15 please?

16 (Whereupon, the trial proceeded in
17 confidential session.)

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1 O P E N S E S S I O N

2 JUDGE BARNETT: Please raise your right
3 hand.

4 Whereupon--

5 RISHI MIRCHANDANI,
6 having been first duly sworn, was examined and
7 testified as follows:

8 MR. ELKIN: Michael Elkin, Amazon.

9 DIRECT EXAMINATION

10 BY MR. ELKIN:

11 Q. Good afternoon, Mr. Mirchandani.

12 MR. ZAKARIN: Michael, just one second.
13 With respect to the slides, and given we have gone
14 through some of the slides and discussion about
15 slides already, so this is something of a fool's
16 errand, I suspect, but I have done that before so
17 why not one more time.

18 I will have --

19 JUDGE BARNETT: You have to make your
20 record anyway.

21 MR. ZAKARIN: I will have some objections
22 to some of these slides because they are not
23 predicated on evidence that we have seen, but it may
24 be better, since I don't have objections to most of
25 them, to at least raise them as and when they are

1 put up.

2 I recognize they are not evidence, but,
3 you know, even things that are not evidence can have
4 an impact, so I want to at least address them.

5 JUDGE BARNETT: Thank you.

6 BY MR. ELKIN:

7 Q. Please state your full name for the
8 record.

9 A. My name is Rishi Mirchandani.

10 Q. And, Mr. Mirchandani, where do you work?

11 A. I work at Amazon.

12 Q. And what is your job title?

13 A. My title is head of content acquisition
14 and catalogue.

15 Q. What do your duties and responsibilities
16 entail?

17 A. I'm responsible for our content
18 acquisition strategy, so that's licensing content
19 from record labels and music publishers. And I also
20 oversee our digital operations, which is responsible
21 for ingesting content and metadata from our content
22 partners, as well as third parties.

23 Q. And for how long have you worked at
24 Amazon?

25 A. For four years.

1 Q. And do you have a university degree?

2 A. I do. I graduated from the University of
3 Pennsylvania in 1996 with a Bachelor of Arts in
4 economics. I also received an MBA from the Harvard
5 Business School in 2003.

6 Q. Okay. Would you please tell the panel
7 the various jobs that you have had since graduating
8 from the University of Pennsylvania with your
9 economics degree?

10 A. Sure. For two years immediately after
11 college, I worked in investment banking as Credit
12 Suisse First Boston. Following that I worked for
13 two and a half years in private equity at J.P.
14 Morgan Partners.

15 At that point I returned to business
16 school. While I was in business school, I decided I
17 wanted to make a career change. Music had always
18 been an interest of mine. I grew up playing piano
19 and guitar. And this was in the period of 2001 to
20 2003, so it was after Napster had arrived on the
21 scene, the earliest streaming services had been
22 developed, and it was pretty clear that the coming
23 five to ten years, we were going to witness a
24 significant transformation in the music industry.

25 I thought it would be an interesting time

1 to work in the industry and help drive that
2 transformation.

3 So after graduating from Harvard Business
4 School, I worked for a year at Giant Step, which was
5 a music marketing and life-style company and record
6 label in New York. From there I moved to Ultra
7 Records, which was an independent dance and
8 electronic label, where I was the GM and CFO for two
9 years.

10 After Ultra Records I worked within the
11 RCHI Label Group. That was a label group owned by
12 Sony Music. I was the VP of marketing and
13 operations where I oversaw our marketing and
14 promotion budgets. I worked at Sony for five years.

15 Following Sony I worked at Turntable.fm.
16 Turntable.fm was a digital music startup. It
17 allowed customers to listen to music on-line
18 synchronously with other customers in virtual chat
19 rooms. I was the VP of operations there,
20 responsible for all business operations including
21 content licensing.

22 Following Turntable, I moved to Amazon
23 where I have been for the last five years.

24 JUDGE BARNETT: If you could either sit
25 forward or pull the microphone a little bit closer.

1 THE WITNESS: Is that better?

2 JUDGE BARNETT: Yes, thank you.

3 BY MR. ELKIN:

4 Q. So you have worked in the, in and around
5 the music industry for 15 years; is that correct?

6 A. I have, just about 15 years.

7 Q. And during the time that you have been
8 working in the music industry, have you had occasion
9 to negotiate license agreements with record labels
10 and music publishers?

11 A. I have. I have negotiated hundreds of
12 licensing agreements with both record labels and
13 music publishers.

14 Q. And have you had experience in building
15 innovative digital music services?

16 A. I have, both at Turntable and now at
17 Amazon.

18 Q. And did you prepare any written direct
19 testimony in connection with this proceeding?

20 A. I did.

21 Q. Why don't you turn to the first tab in
22 the binder in front of you. Can you identify that
23 document?

24 A. Yes. This is my written direct
25 testimony.

1 Q. And if you could please turn to the last
2 page in the binder, the declaration of Rishi
3 Mirchandani. Is that your signature under, atop of
4 your name?

5 A. It is.

6 MR. ELKIN: I would move into evidence
7 Amazon Trial Exhibit 1.

8 MR. ZAKARIN: No objection.

9 JUDGE BARNETT: Exhibit 1 is admitted.

10 (Amazon Exhibit Number 1 was marked and
11 received into evidence.)

12 BY MR. ELKIN:

13 Q. And, Mr. Mirchandani, did you prepare any
14 written rebuttal testimony in this proceeding?

15 A. I did.

16 Q. Could you please turn to Amazon Trial
17 Exhibit 111 in the binder.

18 A. Okay.

19 Q. Could you identify that for the record,
20 please?

21 A. Yes. This is my written rebuttal
22 testimony.

23 Q. Let me ask you to take a look at the last
24 page of this exhibit, the declaration of Rishi
25 Mirchandani. Is that your signature above your

1 name?

2 A. That is.

3 MR. ELKIN: I move for the admission of
4 Amazon Trial Exhibit 111.

5 MR. ZAKARIN: No objection.

6 JUDGE BARNETT: 111 is admitted.

7 (Amazon Exhibit Number 111 was marked and
8 received into evidence.)

9 BY MR. ELKIN:

10 Q. Thank you. Do you have an understanding
11 as to how Amazon got its start in business?

12 A. I do.

13 Q. Can you please tell the panel?

14 A. Amazon launched --

15 Q. I think the panel is familiar with
16 Amazon, but just briefly would be a nice
17 introduction.

18 A. Sure. Amazon launched in 1995 as the
19 earth's largest book store. Amazon realized that
20 selling books and other products over the Internet
21 to consumers gave it the opportunity to deliver on a
22 number of previously unrealized benefits, including
23 competitive pricing, increased selection, depth of
24 content, personalization, and convenience.

25 Over time Amazon expanded into other

1 categories, including music, video, and consumer
2 electronics.

3 Q. And do you have an understanding as to
4 whether Amazon has any core principles to help guide
5 its business?

6 A. It does. All Amazon businesses are
7 informed by a few core principles. They include
8 customer obsession, long-term thinking, innovation
9 and operational excellence.

10 Q. Now, turning to music, how did Amazon end
11 up in the digital music business?

12 A. Amazon entered music as a second
13 category, launched a CD store in 1998. Over the
14 years as consumers have continued to shift their
15 consumption habits from physical CDs to MP3s and now
16 to streaming, Amazon has really committed to
17 offering music to its customers in any format in
18 which they please.

19 Q. Would you please take the panel through
20 Amazon's current digital music offerings?

21 A. Sure. I would be happy to.

22 In addition to our physical store and MP3
23 store, we have five Subpart B and C offerings. We
24 have a purchased content locker and a paid locker.
25 We have Amazon Prime Music, which is a streaming

1 service bundled with Amazon Prime. And then in
2 October of last year we launched Amazon Music
3 Unlimited and Amazon Music Unlimited for Echo.

4 Q. Okay. The -- you know, there was a
5 statement earlier in these proceedings that I
6 believe to the effect that Amazon was not a
7 participant in the Phonorecords II settlement.

8 Do you have any institutional knowledge
9 as to whether or not Amazon, in fact, did
10 participate in the Phonorecords II proceeding?

11 A. Yes. It is my understanding that Amazon
12 did participate in Phonorecords II. Amazon was
13 looking to launch multiple locker services and so
14 was extremely interested in the proceedings.

15 In addition, it was my understanding that
16 Amazon was the party that pushed to include the
17 definition of physical phonorecords in a purchased
18 content locker. To the best of my understanding,
19 Amazon was the only service that is actually -- that
20 is participating now that actually took advantage of
21 that definition in launching our AutoRip service.

22 JUDGE STRICKLER: Good afternoon.

23 THE WITNESS: Good afternoon.

24 JUDGE STRICKLER: Was Amazon involved in
25 the subpart -- in the 2012 Phonorecords II

1 settlement negotiations with regard to Subpart B,
2 outside of the locker services?

3 THE WITNESS: My understanding is that
4 Amazon participated through DiMA. I was not a party
5 to those negotiations.

6 JUDGE STRICKLER: So the institutional
7 knowledge that you just referred to was your
8 institutional knowledge of how Amazon negotiated
9 through DiMA?

10 THE WITNESS: Correct.

11 JUDGE STRICKLER: Thank you.

12 BY MR. ELKIN:

13 Q. And did you have occasion to speak to
14 anyone at Amazon who participated in the
15 negotiations with DiMA?

16 MR. ZAKARIN: I am going to object
17 because I don't believe any of this is in his
18 witness statement, either direct or rebuttal.

19 MR. ELKIN: I -- this is all background.
20 And it was a suggestion that was made, but that's
21 fine. I can't sit here and tell you that it is
22 there and I was trying to be helpful but --

23 JUDGE BARNETT: The objection is
24 sustained. Just go ahead.

25 BY MR. ELKIN:

1 Q. Okay. Are you familiar with the Section
2 115 services that are at issue here?

3 A. I am.

4 Q. What is your understanding of Section
5 115?

6 A. That is the section of the copyright law
7 under which we obtain mechanical licenses for our
8 Subpart B and Subpart C services, the ones I
9 described a minute ago.

10 Q. What was Amazon's first Section 115
11 service?

12 A. It was our paid locker and purchased
13 content locker.

14 Q. And when did it launch that service?

15 A. In July of 2012.

16 Q. Could you tell the panel a little bit
17 more about Amazon's locker services?

18 A. Sure. Our purchased content locker
19 service allows a customer who buys content on Amazon
20 to access that content through our content locker.
21 So that's through apps that they can access on their
22 phone, desktop computer, or through other devices.

23 Our paid locker service allows the same
24 customers who choose to upload up to 250,000 tracks
25 the ability to do so for an annual fee.

1 Q. And do you know whether Amazon relied on
2 the settlement agreement in Phonorecords II in
3 launching its locker services?

4 A. We did.

5 Q. And how do you know that?

6 A. I joined the company shortly after those
7 locker services launched, and so my, my direct boss
8 at the time had participated in those proceedings,
9 and I understand that we designed those services to
10 fit within the regs.

11 We also, about two months before I
12 launched our AutoRip product which allows a customer
13 who buys a physical CD to access that CD through
14 their purchased content locker. And our ability to
15 launch that was predicated on the settlement
16 agreement that had been negotiated.

17 Q. What is the next Section 115 service that
18 Amazon launched?

19 A. It was Prime Music.

20 Q. And when did Amazon launch Prime Music?

21 A. In June of 2014.

22 Q. Can you describe the consumer experience
23 with Prime Music?

24 A. Sure. Prime Music is a limited catalogue
25 offering. It is bundled with Amazon Prime, which

1 means the customers who are Prime subscribers have
2 access to it. It allows the customer to access
3 interactive streams and limited downloads for
4 off-line playback.

5 When we launched, we had a catalogue of
6 over 1 million tracks, and hundreds of playlists.
7 Today we offer a catalogue of over 2 million tracks,
8 and we have thousands of playlists and stations.

9 Q. Is there any promotional video that you
10 recall having been prepared in the use of the launch
11 of Prime Music?

12 A. Yes, there is.

13 Q. Would you like to take the panel through
14 that?

15 A. Yes, we can show it.

16 (Video played.)

17 BY MR. ELKIN:

18 Q. Mr. Mirchandani --

19 JUDGE STRICKLER: Excuse me, following up
20 on a question you asked before that, Mr.
21 Mirchandani, you said Amazon originally introduced
22 Amazon Prime, had a catalogue of about a million
23 songs and had a certain playlist feature.

24 THE WITNESS: Correct.

25 JUDGE STRICKLER: And certain play

1 functions; is that right?

2 THE WITNESS: Correct.

3 JUDGE STRICKLER: And then there came a
4 time when you enlarged the catalogue and enhanced
5 the functionality?

6 THE WITNESS: So over time --

7 JUDGE STRICKLER: That's a yes or no.

8 THE WITNESS: Yes.

9 JUDGE STRICKLER: Was there any concern
10 when you increased the catalogue or enhanced the
11 functionality that that might drain listeners away
12 from subscription services in Amazon?

13 THE WITNESS: There was not.

14 JUDGE STRICKLER: There was no such
15 concern?

16 THE WITNESS: There was not.

17 JUDGE STRICKLER: Why did you increase
18 the available catalogue?

19 THE WITNESS: There is a couple of
20 reasons. So over time we were able to add -- our
21 content partners were willing to add more content to
22 the service, but there was a core principle that we
23 had in selecting content, which is that new
24 releases, largely releases that were six months or
25 under with very limited exceptions were not included

1 in the service.

2 And from our perspective, in addition to
3 catalogue size, it was that windowing strategy that
4 really differentiated it from other streaming
5 services. And that stayed constant even as we added
6 content to the service.

7 JUDGE STRICKLER: When you -- and how
8 about the increased functionality, what was the
9 reasoning for the increased functionality of Amazon
10 Prime?

11 THE WITNESS: The functionality that we
12 added were algorithmic stations. We had designed
13 the service always to target very casual listeners.
14 And we felt that functionality was consistent with
15 what a casual listener was looking to -- looking for
16 in a streaming service.

17 JUDGE STRICKLER: So when you say you
18 increased the catalogue size and the functionality,
19 you were unconcerned with the possibility that it
20 might drain away subscription -- subscribers.

21 Did you consider that issue and say
22 that's not a concern or the issue just never came up
23 at all?

24 THE WITNESS: Well, like I said, the --
25 given what we were -- given the nature of the

1 content that we were adding, which was largely
2 catalogue content and not new releases, and in
3 addition the fact that the functionality that we
4 were adding was stations functionality, which tends
5 to be targeted at very lean-back customers,
6 combination of those two factors, we didn't think it
7 was going to change -- it would have any further
8 difference on how customers of paid streaming
9 services would react.

10 Our feeling was someone who wanted to pay
11 for a streaming service was going to want a full
12 catalogue. And that was something that we were
13 always thinking about down the line of adding to our
14 portfolio of services.

15 JUDGE STRICKLER: Thank you.

16 BY MR. ELKIN:

17 Q. Were you personally involved in the
18 launch of Prime Music?

19 A. I was. I was responsible for developing
20 our content acquisition strategy and executing it.

21 Q. And do you know whether Amazon relied on
22 the existing regulations under Section 115 in
23 launching Prime Music?

24 A. We did. Yeah, we considered launching
25 solely with voluntary publishing licenses. That

1 wasn't a practical reality. While it is easier to
2 do that on the sound recording side, we really
3 needed to be able to license a full selection on the
4 publishing side. If we were to go out and license a
5 set of sound recordings, we wouldn't know at the
6 time that we licensed them exactly who the
7 publishers were.

8 And so to be able to offer consumers a
9 full album without holes in it because we were
10 missing a publishing deal, we needed to be able to
11 rely on the compulsory license. And the bundled
12 subscription service within Subpart B was one
13 through which we could license the service.

14 Q. What was the next Section 115 services or
15 service or services that Amazon launched after Prime
16 Music?

17 A. It was Unlimited and Unlimited for Echo.

18 Q. When you say Unlimited, that's Amazon
19 Music Unlimited and Amazon Music Unlimited for Echo?

20 A. Correct.

21 Q. And when did those services launch?

22 A. Those launched in October of 2016.

23 Q. Can you describe the consumer experience
24 with these services?

25 A. I can. I have a promotional video that

1 we released around launch.

2 (Video played.)

3 BY MR. ELKIN:

4 Q. So could you please tell the panel a
5 little bit more about Amazon Music Unlimited and
6 Amazon Music Unlimited for Echo?

7 A. Sure. As I noted earlier, we always had
8 an eye towards launching a full catalogue service
9 that would be targeted at music aficionados and that
10 was our strategy with launching Amazon Music
11 Unlimited.

12 Unlimited has a catalogue of tens of
13 millions of tracks. It includes all new releases,
14 unlike Prime Music, and allows customers to access
15 interactive streams and off-line, limited downloads
16 for off-line playback. Similar to Prime Music, it
17 also features playlists and stations.

18 Unlimited for Echo is a limited
19 functionality service; the lower price point that
20 was targeted at more mainstream customer. It has
21 the same catalogue of music as Amazon Music
22 Unlimited, but it can only access on a single
23 non-portable device.

24 Q. Were these services launched in reliance
25 on certain categories under Subpart B of Section

1 115?

2 A. They were. Amazon Music Unlimited, to
3 launch Amazon Music Unlimited, we relied on the
4 portable subscription service mixed use category and
5 to launch Unlimited for Echo, we relied on the
6 non-portable streaming only category, both in
7 Subpart B.

8 Q. Did the promotional video for Amazon
9 Music Unlimited and the Echo tier, there was an Echo
10 that was featured. Could you just take the panel
11 through very briefly how the Echo works?

12 A. Sure. I would be happy to.

13 I think we have a slide that highlights
14 some of the functionality. So the Echo is a
15 voice-activated device. It is powered by Alexa.
16 Alexa is an operating system that powers the Echo,
17 as well as Echo Dot and Tap and third-party devices.

18 What sets the device apart is that
19 voice-user interface and what we call far field
20 voice recognition technology.

21 What that means is when you say "Alexa,"
22 which is what we call the awake word, the device is
23 listening for your command. So if you have an Echo
24 in your kitchen, you can say "Alexa, what is the
25 weather?" And you will hear a weather report.

1 And you can say "Alexa, play music" and
2 the device will start playing back music, could be
3 from an Amazon Music service or from a third-party
4 music service. We have also integrated with or
5 allowed third parties to integrate apps into the
6 device, so you can link it to your Uber account for
7 example and order an Uber.

8 The striking thing for us about the
9 device was it really reduced the friction of
10 customers interacting with music service. Like I
11 said, you can simply say "Alexa, play music," and it
12 will start playing music. And so we feel it has
13 given us the opportunity to really broaden the
14 customer base for streaming music services.

15 Q. Were you personally involved in the
16 launch of these two services, Amazon Unlimited Music
17 and Amazon Unlimited Music With Echo?

18 A. I was. I was involved in the development
19 of the idea for the services, the strategy for the
20 services, as well as the content acquisition
21 strategy and execution of that -- of that content
22 acquisition.

23 Q. Okay. So changing, shifting gears to
24 Amazon's rate proposal, are you aware that the
25 setting of rates in this proceeding is governed by

1 four statutory factors, sometimes referred to as the
2 801(b) factors?

3 A. I am.

4 Q. And without commenting on your knowledge,
5 on the screen there are the four factors. Are these
6 the ones that, that Amazon considered in setting --
7 in developing its rate proposal in this case?

8 A. Yes, they are.

9 JUDGE STRICKLER: Were you involved in
10 establishing the rate proposal in this case?

11 THE WITNESS: I was.

12 JUDGE STRICKLER: Thank you.

13 BY MR. ELKIN:

14 Q. And are you aware that -- are you aware
15 that Amazon is advocating for a certain royalty rate
16 and terms in this proceeding?

17 A. I am.

18 Q. And do you know what rates and terms
19 Amazon is seeking?

20 A. I do. We are largely suggesting that the
21 current rate structure be rolled over with four
22 minor modifications.

23 Q. Before we get into the meat of Amazon's
24 proposal, which is going to require us to get into
25 restricted area, I am going to ask -- I am going to

1 ask a few more questions about some of the four
2 changes that you are suggesting.

3 If you could just take us through those
4 changes.

5 A. Sure. We are proposing four changes.
6 The first is a clarification around family plans.
7 The second is a discount for student plans. The
8 third is a discount for annual plans. And the
9 fourth change is to allow a deduction for app and
10 carrier fees.

11 Q. And if you could just take us through the
12 rationales for each of these plans and commenting
13 why you think, if you do, that they are fair
14 proposals.

15 A. Okay. For family plans, we're seeking a
16 clarification that the per subscriber minima and
17 subscriber base royalty floors apply at an account
18 level and not per user. In addition, we're
19 suggesting that those minima be increased by
20 50 percent, which is consistent with the pricing
21 that we see in the market for family plans.

22 Today they are generally marketed at a
23 50 percent premium to individual plans.

24 We think this is a fair proposal because
25 it is -- for two reasons. First, it is in line with

1 the market pricing that we see. And, second, if the
2 -- if the per-subscriber minima and subscriber-based
3 floors were applied at a per-user level, we think
4 rights owners could end up -- could end up in a
5 situation where they would earn a disproportionate
6 return on those accounts.

7 For example, it is customary for family
8 accounts to allow up to six users. And if there is
9 a case where a family had six users, we would be
10 paying a 500 percent premium on the minima.

11 And if you go back 20 years when we were
12 in a physical media world, I don't think most
13 families would buy five copies of a CD to listen
14 within their house. I think it would more likely
15 that there would be one CD purchased that would be
16 shared amongst the house.

17 At the same time we think family plans
18 are an important tool for the industry because they
19 give us an opportunity to actually increase the
20 revenue that we do receive compared to an individual
21 plan.

22 Q. And what about with regard to the student
23 plans?

24 A. Student plans we see as an important
25 customer acquisition tool to get students into paid

1 streaming services. Again, to go back 20 years to a
2 physical media world, I think students were very
3 avid consumers of music. They continue to be today,
4 but there is lots of ways for them to access music.

5 There is free services and there is
6 always the specter of piracy. We think it is in our
7 interest and in rights owners' interests to be able
8 to get these, this age of customer into a paid
9 streaming service to make sure they understand the
10 value of subscribing to a streaming service. And
11 then we can retain them over time, once they
12 graduate from college into a full-paying customer.

13 Q. Okay. And what about with respect to
14 annual plans?

15 A. Annual plans seem to be an effective
16 customer retention tool. By getting a customer to
17 subscribe and commit upfront to an annual
18 subscription, we are able to reduce the churn in the
19 service. We have seen customary discounts both
20 offered to the consumer and in direct deals of
21 16.67 percent.

22 What that percentage represents is an
23 effective discount based on a customer paying for
24 ten months to get the benefit of 12. So for a
25 subscription service that would normally cost 10

1 dollars a month, instead of paying \$120 over the
2 course of the year, they can pay \$100 upfront.

3 Now given the value in driving customer
4 retention, we think this is an appropriate discount
5 to have in the rights as well.

6 JUDGE STRICKLER: Just before you get
7 into the app and carrier fees, because that is going
8 to switch us over, is part of the reason, in
9 addition to what we see on the screen and what you
10 just testified to, for the proposed adjustments for
11 family plans and student plans based on the concept
12 that the willingness to pay, which incorporates
13 ability to pay, of students and additional members
14 of the family might not be as high as it is for
15 people who would subscribe under the regular
16 subscription price?

17 THE WITNESS: It is. I think there are
18 two slightly, the way I would think about it, there
19 is two slightly different dynamics at work.

20 In a family plan, to go back to the
21 example I gave before where you have a family of
22 four listening to music, I don't think that it is
23 likely that a family would pay for four ten-dollar
24 subscriptions. So in that case, yeah, I think given
25 the desire to add other people to an account, the

1 price can escalate very quickly.

2 There were family accounts in the market
3 that, you know, have had a kind of incremental price
4 per subscriber in the past. To my understanding
5 they haven't gotten a lot of traction. The market
6 does seem to have moved to this single price point
7 with a 50 percent premium. That does seem to have
8 more traction than what we saw in the past.

9 And then with student plans, yes, I think
10 it is a combination of willingness to pay, and then
11 I think the other ways that students are typically
12 accessing music, like I said, there are a lot of
13 free services, you know, we have seen from public
14 research out there that suggests free services like
15 YouTube are an important music discovery channel for
16 that age demographic.

17 JUDGE STRICKLER: Does willingness to pay
18 apply as well to the justification for the annual
19 plans or is it just the long-term incentive to
20 convert?

21 THE WITNESS: There -- I guess, you know,
22 the way we think about that is incentive to reduce
23 churn in the service kind of drives that. And so we
24 think it is a benefit for services to be able to
25 offer those plans and that the benefit of increased

1 retention kind of flows through the value chain.

2 JUDGE STRICKLER: Thank you.

3 BY MR. ELKIN:

4 Q. And lastly the app and carrier fees, what
5 is the justification for that?

6 A. So we distribute our services both
7 through app stores and mobile carriers. These are
8 important distribution channels. They allow us to
9 reach a much broader customer base.
10 They also make it easier for customers to
11 pay for their subscriptions, which reduces friction.
12 In some cases those channels have additional
13 transaction costs for us to be able to access them.

14 And given their ability to access,
15 increase the numbers of customers we can access, we
16 think those costs should be shared through the value
17 chain with a cap of 15 percent.

18 JUDGE STRICKLER: Why should those
19 particular costs be shared, because they are the
20 cost of revenues, the cost incurred in order to
21 drive revenues?

22 THE WITNESS: To acquire customers, it is
23 -- there are unique, I think those are unique
24 channels that when we access, they allow us to bring
25 many more customers into our service. They also

1 introduce a new cost of distribution.

2 And I think that, I think it is
3 worthwhile for everyone in the value chain to absorb
4 that cost because of the ability to expand the
5 number of customers we reach.

6 JUDGE STRICKLER: But, I mean, on a high
7 level, isn't -- aren't all the costs that Amazon
8 Digital or Amazon Music incurs, costs that at the
9 end of the day are designed to drive revenues?
10 That's the whole reason why you would incur the cost
11 in the first place, right?

12 THE WITNESS: That's correct. But, you
13 know, there are certain cases where we may choose to
14 avail ourselves of a marketing channel or not
15 because of these incremental costs.

16 So, you know, if it is less profitable
17 for us to acquire customers in some of these
18 channels, we may not pursue them. And, you know, to
19 give some context on some of these costs, these are
20 types of costs that we have seen other content
21 partners share in different contexts.

22 So, yes, they are costs in our P&L, but
23 obviously we're not trying to put every cost in
24 here.

25 JUDGE STRICKLER: Conceptually then it is

1 still staying at a higher level. How do you
2 distinguish between costs that -- since all costs
3 really are incurred so that you can ultimately drive
4 revenues, where is the dividing line or what are the
5 features that would help us understand which costs
6 should be deductions so, therefore, the Copyright
7 Owners are sharing in the costs, they are excluded
8 from the royalty base, and which costs should not be
9 -- should not be excluded from the royalty base?

10 How do we decide -- by that I mean how do
11 you decide where that line is when you make your --
12 your proposal?

13 THE WITNESS: Right. So I guess the
14 distinction I would make here, and I think there is
15 different, you know, rate proposals out there, but I
16 look at these costs as distribution costs, which
17 really help us expand our customer base. Something
18 that is not a distribution cost, you know, would be
19 our normal kind of credit card processing or our
20 normal kind of marketing costs.

21 So I look at these as something that are
22 specifically helping us very directly access a new
23 distribution channel.

24 JUDGE STRICKLER: So it is whether or not
25 the cost is somewhat attenuated from the

1 distribution channel or not?

2 THE WITNESS: That's how we think of, you
3 know, when we think about apps and carrier fees,
4 those are two specific distribution channels that we
5 think about.

6 JUDGE STRICKLER: Thank you.

7 THE WITNESS: Yeah.

8 JUDGE FEDER: Just going back to the
9 annual plans, and you testified that you do it to
10 stop churn, to keep people from churning off of your
11 product.

12 THE WITNESS: Um-hum.

13 JUDGE FEDER: Have you done any analysis
14 of where they go when they churn off your product?
15 Are they going to other Services, or are they
16 dropping out of the music market altogether or are
17 they going to piracy?

18 THE WITNESS: We haven't. We have just
19 are a limited service. We just launched a few
20 months ago. But I think the -- the notion of annual
21 billing in a subscription service, not even just a
22 music service, but any sort of subscription service,
23 I do think that there has been evidence that annual
24 plans will have increased retention.

25 There is two reasons. One, someone is

1 making a bigger upfront commitment, and the second
2 is, you know, every month they are not being billed
3 and sort of being posed the question: Do I want to
4 cancel my subscription?

5 So that's kind of a one-time-a-year
6 thought process as opposed to something that is
7 happening every month.

8 JUDGE FEDER: I understand what the
9 benefit is to Amazon of retention.

10 THE WITNESS: Yeah.

11 JUDGE FEDER: But if that customer leaves
12 Amazon to go to Google or Spotify, Google and
13 Spotify are also paying royalties to songwriters and
14 publishers.

15 So it benefits you, it doesn't
16 necessarily -- retaining that customer doesn't
17 necessarily benefit the songwriters and publishers;
18 is that a fair statement?

19 THE WITNESS: In the hypothetical example
20 where someone was bouncing around from Service to
21 Service, no. The way we think about consumers and
22 how they interact with music service is you build up
23 an investment in a Service over time, so you build
24 playlists, you add stuff to your collection, and,
25 you know, the way we think about someone churning

1 out is that they likely no longer see value in the
2 service.

3 I do agree there is a hypothetical
4 scenario where someone could hop from Service to
5 Service, but, you know, when we think about
6 retention, I think our view is if the customer is
7 seeing value in the service, they are going to stick
8 around. And if they churn out, they may go to
9 another Service, but they just may not be going
10 anywhere.

11 JUDGE FEDER: And you just don't have
12 that data?

13 THE WITNESS: Correct.

14 JUDGE FEDER: Thank you.

15 THE WITNESS: Okay.

16 BY MR. ELKIN:

17 Q. So just turning to one other issue,
18 before we get into the meat and potatoes of your
19 consideration of the 801(b) factors, to be clear is
20 Amazon seeking to eliminate any of the
21 subscriber-based mechanical-only royalty floors in
22 any of the existing rate categories?

23 A. We are not.

24 Q. And why not?

25 A. Yeah, our rate proposal contains a number

1 of royalty prongs, and we think those are important
2 ones to ensure that songwriters and, you know,
3 rights owners are earning a fair return.

4 Q. Okay.

5 MR. ELKIN: Panel, we have reached that
6 point in Mr. Mirchandani's direct examination where
7 we need to go into restricted session. And I will
8 just point out, if I could, Your Honors, that we do
9 have two in-house senior executive lawyers at Amazon
10 who are only going to be covering material, at least
11 on the direct, with respect to material that Amazon
12 has deemed restricted. So I am looking for your
13 panel's guidance with respect to whether those
14 individuals could remain in the courtroom.

15 JUDGE BARNETT: It is Amazon information?

16 MR. ELKIN: Yes.

17 JUDGE BARNETT: That is restricted?

18 MR. ELKIN: Correct.

19 JUDGE BARNETT: And they are Amazon
20 employees?

21 MR. ELKIN: Yes.

22 JUDGE BARNETT: You are not going to get
23 into any information or materials that you got in
24 discovery or from other parties that they deem to be
25 restricted?

1 MR. ELKIN: Correct.

2 JUDGE STRICKLER: And you are
3 representing these Amazon in-house individuals are
4 authorized to hear this restricted information?

5 MR. ELKIN: Yes, they are. They are
6 working directly in connection with this CRB
7 proceeding.

8 JUDGE STRICKLER: So we're not aiding and
9 abetting any breach of confidentiality?

10 MR. ELKIN: No, I will make that
11 representation to the tribunal.

12 JUDGE BARNETT: Last question. Are you
13 going to take 45 minutes in this restricted part of
14 the examination?

15 MR. ELKIN: Yes. I am pretty confident
16 that the material that we have left will probably
17 eclipse the amount of time we have today.

18 JUDGE BARNETT: Okay. So for those of
19 you in the hearing room who do not have privileges
20 to hear restricted or confidential information, if
21 you would please leave the room. And since we're
22 going to be going until 5:00 o'clock, you don't need
23 to hang out, unless you are waiting for somebody in
24 the room.

25 While we're waiting, I will embarrass our

1 program specialist, Anita Blaine, and introduce her
2 to the crowd. A lot of you have communications with
3 Anita, and this is who she is.

4 MR. ELKIN: Thank you for your help.

5 (Whereupon, the trial proceeded in
6 confidential session.)

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1	C O N T E N T S			
2	WITNESS	DIRECT	CROSS	REDIRECT RECROSS
3	GREGORY K. LEONARD			
4		1070	1144	1276
5	RISHI MIRCHANDANI			
6		1300		
7				
8	AFTERNOON SESSION: 1193			
9				
10	CONFIDENTIAL SESSIONS: 1077-1091,			
11	1245-1275, 1293-1299, 1335-end			
12				
13	E X H I B I T S			
14	EXHIBIT NO:	MARKED/RECEIVED	REJECTED	
15	GOOGLE			
16	551		1295	
17	552		1295	
18	560		1295	
19	694		1295	
20	695		1072	
21	1701		1277/1279	
22	AMAZON			
23	1		1305	
24	7		1368	
25	10		1368	

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1 CERTIFICATE

2

3 I certify that the foregoing is a true and
4 accurate transcript, to the best of my skill and
5 ability, from my stenographic notes of this
6 proceeding.

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9 3/16/17



10 Date

Signature of the Court Reporter

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